No. 2994

In the

United States Court of Appeals

For the Ninth Circuit

No. 14695

See Vol. 2993

MID-STATES INSURANCE COMPANY, a corporation, and THE ANGLO CALIFORNIA NATIONAL BANK OF SAN FRANCISCO,

Appellants,

vs.

AMERICAN FIDELITY AND CASUALTY COMPANY, INC., a corporation, AMERICAN PLAN CORPORATION, a corporation, MARK HART, JOSEPH LOTZ and RALPH L. SMEAD,

Appellees.

Appeal from the United States District Court for the Northern District of California, Southern Division.

Honorable
Michael J. Roche,
Judge Presiding.

BRIEF AND ARGUMENT FOR APPELLANT, MID-STATES INSURANCE COMPANY.

LEWIS SCHIMBERG,
MAYNARD GARRISON,
Attorneys for Appellant, Mid-States Insurance Company.

WALLACE, GARRISON, NORTON & RAY,
Of Counsel.

THE GUNTHORP-WARREN PRINTING COMPANY, CHICAGO

INDEX.

ALPHABETICAL LIST OF CASES AND OTHER AUTHORITIES.

In the

United States Court of Appeals

For the Ninth Circuit

No. 14695

MID-STATES INSURANCE COMPANY, a corporation, and THE ANGLO CALIFORNIA NATIONAL BANK OF SAN FRANCISCO, *Appellants,* *vs.* AMERICAN FIDELITY AND CASUALTY COMPANY, INC., a corporation, AMERICAN PLAN CORPORATION, a corporation, MARK HART, JOSEPH LOTZ and RALPH L. SMEAD, *Appellees.*	Appeal from the United States District Court for the Northern District of California, Southern Division. Honorable Michael J. Roche, Judge Presiding.

BRIEF AND ARGUMENT FOR APPELLANT MID-STATES INSURANCE COMPANY.

Jurisdiction.

This is an action brought by Mid-States Insurance Company, an Illinois corporation ("Mid-States"), against (1) American Fidelity and Casualty Company, Inc., a Virginia corporation, licensed to do business in the State of California ("American Fidelity"); (2) The American Plan Corporation, a New York corporation doing business in California ("American Plan"), the manager of the United States automobile physical damage insurance business of American Fidelity; (3) Mark Hart, a resident of the State

of New York, President of American Plan; (4) Joseph Lotz, a resident of California; (5) Ralph L. Smead, a resident of California; (6) L. Sudekum and H. Arthur Will (sued as John Will). The defendants L. Sudekum and John Will were not served with process and accordingly were not parties to the action. The case was tried to the court without a jury and the court entered judgment for the defendants (R. 141). Appellant Mid-States appeals from that judgment.

Plaintiff's complaint (R. 8-19) charges that the defendants conspired to defraud Mid-States and that this conspiracy was actually carried out in breach of the fiduciary obligations of Lotz to Mid-States. The defendant Lotz was the general agent of Mid-States for the State of California and the general agent of American Fidelity for the State of California with power to accept proposals for insurance covering automobile physical damage and to adjust losses for each of the companies for the respective periods alleged in the complaint (R. 8, 9, 10, 36 and 37). The complaint prays for damages in the amount of $297,097.91 and for $50,000.00 as exemplary and punitive damages (R. 18). Each of the defendants filed answers denying the conspiracy to defraud or the alleged acts in concert in breach of the defendant Lotz's fiduciary duty as agent of Mid-States (R. 34-42).

Three counterclaims were filed by American Fidelity, one by American Plan and two by Lotz. The first counterclaim filed by Lotz was amended by leave of court, and the amended counterclaim was thereafter dismissed without leave to further amend, and an appeal from that order was dismissed by this court in case No. 13756. Two of the counterclaims filed by American Fidelity and the counterclaim filed by American Plan were abandoned prior to the commencement of the trial and no proof support-

ing the third counterclaim filed by American Fidelity or the second counterclaim filed by Lotz was offered at the trial and, accordingly, judgment was entered in favor of the plaintiff on all of the counterclaims, none of which is involved in this appeal.

The Anglo California National Bank ("Anglo") filed a complaint in intervention by permission of the court and appeared as a third party plaintiff (R. 50-64). During the period of the acts alleged in the Mid-States complaint the defendant Lotz endorsed and deposited in his account certain checks which were delivered to him but which were drawn to the order of Mid-States. Mid-States sued Anglo in a separate action in the United States District Court for the Northern District of California, Southern Division, Case No. 31311 (R. 3-7), on the theory that Lotz was not authorized to endorse checks payable to Mid-States, and that suit was settled after trial but before judgment by the payment of $37,500.00 by Anglo to Mid-States. Anglo seeks recovery of this amount from the defendants on the alternative grounds (a) that the endorsement of checks by Lotz was an act in furtherance of the fraudulent conspiracy upon which the principal action is based, or (b) by way of subrogation should Mid-States recover in the principal action (R. 98). Judgment was entered against Anglo and in favor of the defendants and Anglo has appealed from that judgment. Mid-States has no interest in Anglo's claim against the defendants for recovery of the amount paid by Anglo to Mid-States in settlement of the latter's suit against it, or in Anglo's appeal in this case.

The jurisdiction of the United States District Court is founded upon Title 28, U. S. C. A., Section 1332. The United States Court of Appeals for the Ninth Circuit has jurisdiction of this appeal under Title 28, U. S. C. A., Sections 1291 and 1293.

STATEMENT OF THE CASE.

Mid-States' complaint alleged that the defendants, by means of various acts and transactions in concert, engaged or participated in a conspiracy to defraud plaintiff and in the breach or violation of Lotz's fiduciary duty as agent of Mid-States, and that as a direct result thereof Mid-States suffered damages. The complaint prayed for a judgment in the amount of $297,097.91, plus exemplary and punitive damages in the amount of $50,000.00.

Both Mid-States and American Fidelity are insurance companies engaged in writing automobile physical damage insurance. American Plan is the United States Manager of the automobile physical damage insurance business of American Fidelity. Both Mid-States and American Fidelity during the period involved in this action were licensed to and did transact business in the State of California.

On May 15, 1947, Mid-States appointed Lotz its general agent in California (Plaintiff's Exhibit 1, R. 176-177, 621) and he continued as such general agent until January 21, 1952 (Plaintiff's Ex. 33). American Fidelity appointed Lotz its general agent for the State of California for like insurance purposes on November 27, 1950 (R. 38). Lotz was authorized with respect to each company to collect premiums on insurance written by him for such company and to adjust losses subject to approval of the company (R. 38).

Lotz' agencies with both Mid-States and American Fidelity were carried out under the so-called "retrospective plan". Under this plan Lotz became indebted to the company for which he wrote insurance for the entire amount of the premium but had a so-called credit period within

which to pay it (R. 177-178). Lotz' first contract with Mid-States, which was dated May 15, 1947, called for a credit period of sixty days (R. 316). This was increased to seventy-five days for the period from May 1, 1951 to September 1, 1951 by a letter from Mid-States (Def.'s Exhibit C), and then reduced by the contract dated September 1, 1951, to sixty days (Plaintiff's Exhibit 2, R. 317). Lotz' contract with American Fidelity provided for a credit period of 75 days within which to pay the premiums on insurance written for it (R. 709, 760). Under his contract with Mid-States Lotz, subject to the approval of Mid-States, had the right to appoint sub-agents who were entitled to an immediate commission upon the premiums collected by them. Under both agency arrangements (except as is hereinafter noted) Lotz was not entitled to receive any commission for himself or any sub-agent until after the policy had expired, his commission being dependent upon the losses incurred under the policy (R. 101-102). Mid-States had a so-called "retention" of twenty percent (20%) under its first contract with Lotz, which was subsequently reduced to fifteen percent (15%), and it had a retention of fourteen percent (14%) under the contract of September 1, 1951 (R. 179-181, 316, Plaintiff's Exhibits 1 and 2, Def.'s Exhibit C). At the expiration of the policies any balance after deducting the losses and retention would be paid to Lotz. Under Lotz' contract of September 1, 1951 with Mid-States, he was permitted to retain fifteen percent (15%) of the premiums subject to later adjustment for losses and was required initially to remit only the balance to Mid-States (Plaintiff's Exhibit 2). Under his contract with American Fidelity he was guaranteed a commission of twenty percent (20%) regardless of losses (R. 763).

The agency contract of September 1, 1951 with Mid-States provided in part:

"* * * All premiums received by the Agent shall be held by such Agent as trustee for the Company.

"* * * The keeping of an account with the agent on the company's books, as a creditor and debtor account, is declared a record memorandum of business transacted, and neither such keeping of account, nor alteration in compensation rate nor failure to enforce prompt remittance or compromise or settlement or declaration of balance of account, shall be held to waive the understanding that the premiums collected by the agent are trust funds. * * *"

During the period from May, 1947, to April, 1951, Lotz procured a substantial amount of insurance business for Mid-States in California (R. 188). During that period Lotz paid Mid-States all moneys due it although he was delinquent at various times for periods of ten days to two weeks (R. 188-189, 210, 308-314, 345-350, Def's Exhibits A and F). The record is devoid of any evidence of any wrongful acts on the part of Lotz during that period.

Following Lotz' appointment as general agent in California for American Fidelity, he placed most of the insurance which he procured in that company until August, 1951, and the amount which he wrote for Mid-States constantly decreased so that by August, 1951, Lotz was indebted to American Fidelity in the amount of approximately $240,000.00 and was indebted to Mid-States in the amount of approximately $30,000.00 (R. 355, 732, Plaintiff's Exhibit 23, pp. 13, 19). Lotz wrote almost no insurance for Mid-States in April, none at all in May, approximately $32,000.00 in June, and none at all in July, 1951 (R. 344-345, Plaintiff's Exhibit 23, p. 13).

The complaint charged that on August 13, 1951, the defendants entered into a conspiracy to defraud Mid-States, and that such conspiracy was carried out by acts of the defendants in concert until on or about November 1, 1951, as a result of which the indebtedness owing by Lotz to

American Fidelity on August 1, 1951 was paid in full and the indebtedness owing by Lotz to Mid-States on that date was increased so that, after effecting collections and cancellations, Mid-States suffered losses in the amount of $297,097.91 (R. 10-18). Mid-States further alleges that at the time of the acts complained of Lotz was insolvent and that this fact was known to the defendants (R. 10).

The Acts Complained Of.

In August, 1951, Lotz was indebted to American Fidelity in the amount of approximately Sixty-six Hundred Dollars ($6,600.00) for commissions on a reinsurance transaction and, when he failed to pay the money, Hart became concerned because Lotz also owed a May balance on account of premiums of approximately Sixty-six Thousand Dollars ($66,000.00) that was to become due on August 15th. Hart therefore asked him to come to New York for a meeting (R. 760, 761). Prior to that time a check in the amount of $53,301.00 that had been issued by Lotz to American Fidelity had been returned unpaid (R. 761). Lotz and Smead, pursuant to Hart's request, went to New York, arriving there on August 13, 1951. There is a dispute in the evidence as to the conversations that occurred at this meeting. Smead and Lotz, in statements signed by them between December 6 and December 18, 1951 (Plaintiff's Exhibits 11, 12, 13, 22 and 31, R. 253-263, 537, 1067, 653-654) outlined in detail what they claim was the conversation at that time. Hart and Feller, attorney for American Fidelity, denied that much of this conversation took place. Hart admitted, however, that he discussed with Smead and Lotz the latter's indebtedness to American Fidelity in the amount of approximately $240,000.00 for premiums on business written for it (R. 762). Hart testified that he was interested in the fifteen percent

(15%) prepaid commission which Lotz was to have under his new contract with Mid-States and any commission income that might accrue to him on what is hereafter described as the Public Service Rewrite (R. 775).

It is undisputed that Lotz immediately proceeded to Chicago to negotiate a new and more favorable agency contract with Mid-States, and that Smead returned to Oakland to proceed with collections from sub-agents. On August 20, 1951, a week after the New York meeting, Hart and Feller flew to Oakland for further conferences with Lotz and Smead. While in Oakland, Feller endeavored to obtain a bank loan of $50,000.00 for Lotz from the Central Bank. During the course of these negotiations Feller conferred with various officers of the bank and a number of legal documents were drafted to evidence a collateral arrangement in respect of commissions earned or to be earned by Lotz (R. 952-954). The negotiations were unsuccessful and the loan was never made. It is also undisputed that Lotz was insolvent on August 1, 1951 and that his insolvency continued at all times thereafter (Plaintiff's Exhibits 23, 25, 26, 27, R. 606-609, 615-616).

On August 22, while in Oakland, Lotz entered into a written agreement with American Plan and American Fidelity (Plaintiff's Exhibit 17) under which (a) Lotz' agency for American Fidelity was terminated and as a result Lotz could write no more policies for American Fidelity; (b) the time within which payment of his indebtedness to American Fidelity in the amount of $240,000.00 was to be made was accelerated so that the entire amount was to be paid by September 15, 1951, although under his 75 day contract period the bulk of that indebtedness would not be due and payable for some time thereafter; (c) Lotz' financial control of his business was taken from him; (d) Lotz' office manager, Smead, was employed by American Plan as its representative with supreme authority

over the financial end of Lotz' agency. Concurrently with the execution of Plaintiff's Exhibit 17, Hart gave Smead a letter which was placed in a sealed envelope under which Smead was promised a bonus of $1,000.00 if he saw to it that American Fidelity was paid in full by September 15, 1951, a period of approximately three weeks (Plaintiff's Exhibit 18; R. 465). Smead later called Hart on the telephone and advised him that he would have no part of accepting the promised bonus (R. 779). A subsequent audit of Lotz' accounts showed that at August 1, 1951, Lotz' total receivables on account of premiums on insurance written by him for American Fidelity were $61,612.01 (Plaintiff's Exhibit 23, p. 13).

There is no dispute in the evidence that between August 13 and November 10, 1951, a period of less than three months, Lotz' indebtedness to American Fidelity in the amount of $240,000.00 had been totally liquidated and his indebtedness to Mid-States had been increased from $30,000.00 to approximately $418,000.00. This result was effected in several ways:

(1) during that period Lotz collected premiums on account of American Fidelity's business in a total amount of a little over $86,000.00, and during the same period American Fidelity received in cash a total of $167,000.00, a sum almost double the collection (Plaintiff's Exhibit 23, p. 13, R. 599). Thus, payment of some $81,000.00 more than was collected on account of American Fidelity's business was paid to it by Lotz. During that same period Lotz collected approximately $199,000.00 on account of Mid-States' business and paid it only $47,000.00, approximately $152,000.00 less than he received (Plaintiff's Exhibit 23, p. 13; R. 598-599). During that same period $434,391.00 of insurance was written by Lotz for Mid-States (R. 598), and only $32,807.68 (net after cancellations) was written for American Fidelity. Thus, American

Fidelity and American Plan, well knowing Lotz' financial position, and with their employee Smead in full financial control of Lotz' agency, knowingly received $81,000.00 more than Lotz collected on their business;

(2) constant and unceasing pressure was put upon Smead, their employee, by American Fidelity and American Plan, by teletype and telephone for immediate payment (Plaintiff's Exhibit 29; R. 803-814). Pursuant thereto, Lotz wrote large amounts of insurance in Mid-States, while insolvent, paying large advance commissions to subagents for the purpose of diverting to American Fidelity premiums received on such business (Plaintiff's Exhibit 23). In most instances, the president or treasurer of American Fidelity or American Plan had actual knowledge of the acts of Smead and Lotz and the sources of the payments and, specifically, of the transfer of a substantial block of insurance policies previously written by the Public Service Insurance Company and rewritten by Lotz for Mid-States (hereinafter referred to as the "Public Service Rewrite");

(3) the Public Service Rewrite involved the cancellation by that company of a number of its own policies representing gross premiums in the amount of $150,000.00. These policies were rewritten in Mid-States for their unexpired terms after Public Service had received the full premiums from the respective assureds. As a result of the rewrite, Public Service was relieved of all remaining liability under the policies and it was accordingly necessary that it pay over to Mid-States, the assuming company, that portion of the premiums representing the unexpired terms of the policies. Lotz paid the Russell and Bond Agency a commission of twenty-five percent (25%) of the total premium balance (R. 848-849, 869), thus receiving only seventy-five percent (75%) of the amount of such premiums. The Public Service checks were made payable

to Mid-States but Lotz placed the payee's endorsement thereon and deposited the funds in his own trustee account. Of a total of approximately $96,000.00 so received by Lotz, approximately $90,000.00 was diverted and paid to American Fidelity (R. 603-606, 637-638; Plaintiff's Exhibit 23, p. 21 and Exhibit 24). Hart knew the checks had been made payable to Mid-States, that payment had been stopped by Public Service on its first check, which had been made payable to Lotz, and that Public Service then issued a new check payable to the order of Mid-States in substitution therefor (R. 862-863). Hart also knew that all or a substantial portion of the proceeds of these checks were being paid to American Fidelity out of Lotz' account (R. 805; Plaintiff's Exhibit 29). As a result of the Rewrite Lotz immediately became indebted to Mid-States for the premiums, less his fifteen percent (15%) advance commission, and the liabilities on the policies were transferred to Mid-States;

(4) on or about October 31, 1951, Lotz' indebtedness to American Fidelity had been reduced by these various transactions to approximately $61,000.00 (Finding III, R. 118). Hart negotiated with Lotz through Smead for the transfer to Mid-States of a block of insurance policies formerly written by Lotz for American Fidelity and on which substantially all of the premiums had been paid to Lotz (R. 663, 892). The amount of premiums involved in this rewrite (hereinafter called the "American Fidelity Rewrite") aggregated more than the unpaid balance then due American Fidelity (Plaintiff's Exhibit 23, p. 13; R. 597). Before effecting the rewrite, Hart telephoned Hatfield for the ostensible purpose of obtaining Mid-States' approval to the rewrite. The telephone conversation, initiated and recorded by Hart, was transcribed and introduced in evidence (Plaintiff's Exhibit 5). The original recording was also introduced in evidence (Defendant's

Exhibit B.) In the course of that conversation, Hart made certain misrepresentations to Hatfield which are hereafter discussed in detail in the argument. Following that telephone conversation, the rewrite was effected, as a result of which liability to the assureds on the policies was transferred to Mid-States, the unpaid balance due from Lotz to American Fidelity was satisfied, and Lotz became indebted to Mid-States for the unearned premiums and was relieved of his obligation to American Fidelity in a like amount.

On November 23, 1951, Hatfield, Vice-President of Mid-States, after receiving a report from Oldberg, Vice-President of Mid-States in Los Angeles, who had visited Lotz' office, came to Oakland from Chicago and for the first time discovered certain of the facts regarding the acts and transactions of the defendants from August 13, 1951. Upon further investigation Lotz told Hatfield the details of these acts and transactions, following which the statements of Smead and Lotz (Plaintiffs' Exhibits 11, 12, 13, 22 and 31) were obtained. On November 27, 1951, Lotz with the prior approval and advice of his counsel, wrote Mid-States stating that he had a plan for continuing in business and ultimately paying his obligations to Mid-States and requesting the latter to approve the same (Plaintiff's Exhibit 6). Mid-States insisted upon and obtained from Lotz an assignment of any commissions which might be due him from American Fidelity, together with an assignment of the assets of his business, the right of access to his books, records and mail (Plaintiff's Exhibits 7, 8, 9, 36), and also entered into an agreement to lease a portion of his office space and his office furniture and equipment (Plaintiffs' Exhibit 14; R. 271-273, 1036-1037). Mid-States then placed its employee Kledzik in the agency for the purpose of analyzing the records and policies written, effecting such collections as were possible, cancelling policies, handling losses and generally performing such details as were nec-

essary to reduce Lotz' indebtedness to it. After learning the facts, Mid-States rejected the arrangement proposed by Lotz in Plaintiff's Exhibit 6. Mid-States continued the foregoing liquidation program until some time in 1952, at which time all of Lotz' office fixtures and equipment were returned to him by delivery of the same to his then attorney, Dusky, at Lotz' request (Plaintiff's Exhibit 32; R. 730). Mid-States' recovery efforts were ultimately successful in reducing Lotz' indebtedness to it substantially. As a result of these efforts and the application by it on Lotz' account of the net proceeds of the settlement made in its action against Anglo for the alleged wrongful payment to Lotz of the Public Service checks made payable to the order of Mid-States, the unpaid balance of Lotz' indebtedness to Mid-States at the time of the trial had been reduced to $281,746.96 (Plaintiff's Exhibit 15, R. 601-602). There is no dispute in the evidence that Lotz is indebted to Mid-States in that amount (Finding V, R. 120; see also the statements of Lotz' attorney in his closing argument, R. 1219-1220).

Following the entry of the Findings of Fact and Conclusions of Law by the trial court (R. 114-140), the court entered judgment in favor of the defendants on plaintiffs' complaint and judgment against the defendants, American Fidelity, American Plan and Lotz on all of their respective counterclaims (R. 141-142). This appeal is not concerned with the judgment order on the counterclaims.

Mid-States thereafter and within the time permitted filed Motions for a New Trial, for Modification of the Findings of Fact and Conclusions of Law, and to Alter and Amend the Judgment (R. 142-156). These motions were denied by the trial court (R. 157).

ERRORS RELIED UPON.

Seventeen statements of points upon which appellant relies on this appeal were filed (R. 159-162), which may for the sake of clarity be placed in the following categories:

(a) Erroneous Conclusions of Law.

1. The court erred in entering judgment that plaintiff take nothing by its complaint.

2. The court erred in failing to find that Lotz was indebted to Mid-States in the sum of $281,746.96 and to enter judgment in favor of the plaintiff against Lotz.

3. The court erred (a) in finding that Lotz was not guilty of concealment of facts which he was under duty to disclose to Mid-States, and that Mid-States did not rely on any non-disclosures by Lotz and (b) in refusing to find that Lotz had violated his fiduciary duties as agent of Mid-States and that the remaining defendants had participated in such breach.

4. The court erred in finding that the defendants did not engage in a conspiracy to defraud plaintiff.

5. The court erred in holding that Mid-States suffered no loss due to any fraud or conspiracy of the defendants.

6. The court erred in denying plaintiffs' motion for a new trial, for modification of Findings of Fact and Conclusions of Law and to alter and amend the judgment.

(b) Erroneous Findings of Fact.

1. The court erred in finding that subsequent to the new contract of September 1, 1951 between Lotz and Mid-States the latter permitted Lotz to use the premiums collected by him for Mid-States to pay his operating expenses, personal drawings, and sub-agents'

commissions and that the funds collected by Lotz for Mid-States constituted a debt in that amount rather than trust funds.

2. The court erred in finding that the statements made by Hart to Hatfield on or about November 1, 1951, in connection with the proposed rewrite by Mid-States of insurance formerly written by Lotz for American Fidelity were not made with intent to deceive or defraud; that said statements were not relied upon by Mid-States; that no fraud or deceit was practiced by American Fidelity or American Plan with respect to such transactions, and that the same was not part of any plan by the defendants to defraud Mid-States.

3. The court erred in finding that the American Fidelity rewrite was not effected for the purpose of enabling American Fidelity to reduce the amount of otherwise uncollectible indebtedness due it from Lotz at the expense of Mid-States.

4. The court erred (a) in finding that the defendants did not know prior to December, 1951, of Lotz' insolvency or that Lotz would be unable to meet his obligations to Mid-States and (b) in failing to find that Lotz was insolvent on or after August 1, 1951, and that the defendants at all times thereafter believed him to be insolvent.

5. The court erred (a) in finding that by the agreement dated August 22, 1951, among American Fidelity, American Plan and Lotz, Smead was given control over the finances of the Lotz agency only as they pertained to the payment of the obligation owed by Lotz to American Fidelity and (b) in failing to find that Smead was the agent of American Fidelity and American Plan and that, while acting as such agent he wrongfully diverted to American Fidelity and American Plan funds belonging to Mid-States.

ARGUMENT.

I.

THE FINDINGS OF FACT AND CONCLUSIONS OF LAW OF THE TRIAL COURT SPECIFIED IN THE ERRORS RELIED UPON ARE CLEARLY ERRONEOUS.

A finding is clearly erroneous when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.

A number of the findings of the trial court relied upon as errors are determinations of mixed questions of law and fact and it is submitted that these findings resulted from erroneous inferences or conclusions drawn from documents or undisputed facts or from an erroneous view of the law.

With respect to the scope of Appellate review, the mandate of Rule 52(a) of the Federal Rules of Civil Procedure is set forth and discussed in *United States* v. *United States Gypsum Co.,* 333 U. S. 364, at 394-5, 68 S. Ct. 525 (1948) as follows:

> "Insofar as this finding and others to which we shall refer are inferences drawn from documents or undisputed facts, * * *, Rule 52(a) of the Rules of Civil Procedure is applicable. * * * Since judicial review of findings of trial courts does not have the statutory or constitutional limitations on judicial review of findings by administrative agencies or by a jury, this court may reverse findings of fact by the trial court which are 'clearly erroneous'. The practice in equity prior to the present Rules of Civil Procedure was that findings of the trial court, when dependent upon oral testimony where the candor and credibility of the witnesses would best be judged,

> had great weight with the Appellate Court. The findings were never conclusive, however. A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."

In *Orvis* v. *Higgins,* 180 F. 2d 537 (C. A. 2, 1950) cert. den. 340 U. S. 810, 71 S. Ct. 37, the Court of Appeals reversed the finding of the trial court that certain trusts made by taxpayers were independent and not reciprocal trusts. The majority opinion stated, at page 539,

> "Where a trial judge sits without a jury, the rule varies with the character of the evidence: (a) If he decides a fact issue on written evidence alone, we are as able as he to determine credibility, and so we may disregard his finding. (b) Where the evidence is partly oral and the balance is written or deals with undisputed facts, then we may ignore the trial judge's finding and substitute our own, (1) if the written evidence or some undisputed fact renders the credibility of the oral testimony extremely doubtful, or (2) if the trial judge's finding must rest exclusively on the written evidence or the undisputed facts, so that his evaluation of credibility has no significance. * * *"

Gindorf v. *Prince,* 189 F. 2d 897 (C. A. 2, 1951) was an action by the plaintiff for compensation for personal services as a financial advisor. The trial court entered judgment for the plaintiff and the Court of Appeals reversed and dismissed the suit on the ground that the evidence required a denial of recovery and that accordingly the findings of the District Court were clearly erroneous. The court said:

> "While certain issues of law do arise, the fundamental question is whether, upon the testimony adduced, the findings of the court in the plaintiff's favor are to be held 'clearly erroneous' under Fed. R. Civ. Proc. rule 52(a) 28 U. S. C. A. We are constrained

to decide that they are and that the judgment must be reversed for dismissal of the action.

"We are under no illusion as to the serious concern, under our own decisions as well as others, with which we must approach the step of reversing a trial judge on issues so dependent upon veracity. Nevertheless, our ultimate responsibility is clear under the rule itself and has been restated by the Supreme Court, notably in *United States* v. *United States Gypsum Co.,* 333 U. S. 364, 395, 68 S. Ct. 525, 542, 92 L. ed. 746, where the Court went on to say: 'A finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.' This court has that definite and firm conviction."

In *Equitable Life Assurance Society of the U. S.* v. *Irelan,* 123 F. 2d 462 (C. C. A. 9, 1948), and in *Smyth* v. *Barneson,* 181 F. 2d 143 (C. A. 9, 1950) this court confirmed this rule, notwithstanding that in the latter case it did not reverse the trial court.

It is also well established that the rule that fact findings supported by evidence and not clearly erroneous must be accepted on appeal does not entrench with like finality the inferences or conclusions drawn by the trial court from its fact findings. Thus, in *Kuhn* v. *Princess Lida of Thurn & Taxis,* 119 F. 2d 704 (C. C. A. 3, 1941), the court said, at pages 705-6:

"The rule does not operate, however, to entrench with like finality the inferences or conclusions drawn by the trial court from its fact findings. And so, while accepting the facts competently found by the trial court as correct, an appellate court remains free to draw the ultimate inferences and conclusions which, in its opinion, the findings reasonably induce. * * * An incorrect conclusion by a trial court qualifies as a 'clearly erroneous' finding, for the correction whereof on appeal rule 52(a) specifically provides."

This case was followed and quoted with approval in *Ball* v. *Paramount Pictures, Inc.*, 169 F. 2d 317 (C. C. A. 3, 1948).

Appellant frankly admits that the oral testimony of the witnesses for the plaintiff and the defendants is in conflict in a number of instances. It is submitted, however, that this conflict does not in any way affect the ultimate findings of fact and inferences which must necessarily be drawn from the documentary evidence and the admissions of the witnesses for the defendants.

Lotz' Admitted Indebtedness.

The court's findings and conclusions of law should be reviewed against the background of Lotz' admitted indebtedness to Mid-States in the amount of $281,746.96. The court found (Finding V, R. 120) that Mid-States' loss on the agency amounted to that sum but refused to enter judgment against Lotz therefor. Counsel for Lotz in his closing argument stated that "Joe knows that he owes Mid-States a lot of money today. He admits this. He owes them hundreds of thousands of dollars * * *." (R. 1219-20). There is no dispute in the record regarding the amount, the detailed breakdown of which is contained in Plaintiff's Exhibit 15, or Lotz' liability to Mid-States therefor. Notwithstanding this uncontroverted evidence, counsel's admission and the court's own finding, it failed to enter judgment against Lotz, but, on the contrary, entered judgment against Mid-States and in favor of Lotz as well as the remaining defendants. The trial court subsequently refused to amend its judgment upon timely motion to amend made by Mid-States pursuant to Rule 59 of the Federal Rules of Civil Procedure (R. 142-146, 157). That this action of the trial court, if allowed to stand, will result in a windfall to Lotz and, accordingly, in a gross miscarriage of justice hardly requires

further discussion in this brief. It obviously reflects the court's misconception of the entire litigation and the further erroneous conclusions which resulted therefrom.

Lotz' Fiduciary Relationship to Mid-States.

It is submitted that the court erred (a) in finding that Lotz was not guilty of concealment of any fact which he was under a duty to disclose to Mid-States and that Mid-States did not rely on any non-disclosure by Lotz, and (b) in refusing to find that Lotz had violated his fiduciary duties as agent for Mid-States and that the remaining defendants had participated in such breach. The trial court made certain subsidiary findings which led to these erroneous conclusions and which are hereafter discussed.

The court concluded that Mid-States' own conduct was to a great extent responsible for its loss and for the creation and continuation of those activities of the Lotz agency which caused such loss (Finding VII, R. 125); that a debtor-creditor relationship existed *with respect to funds representing premiums collected by Lotz,* and that he could use such funds to pay his obligations "provided that no fraud or breach of fiduciary obligations was involved" (R. 105). However, the court later concluded that "Lotz was an independent contractor *as to the operation of the business* * * *." (Italics supplied.)

The court's opinion and findings deal at length with the history of the Lotz agency and the conduct of Lotz and Mid-States with respect thereto. The trial court's conclusion regarding the legal relationship between Lotz and Mid-States is based upon its findings regarding the use of premium funds by Lotz, his accounting methods, his tardiness in payments to Mid-States from time to time, and lack of supervision or examination of Lotz' accounts

by Mid-States prior to the period beginning with August 13, 1951. It is submitted that the undisputed evidence in the case does not support the trial court's conclusions regarding the legal relationship between Lotz and Mid-States.

A great deal of emphasis was placed by the court on the testimony that (a) Lotz was without capital when he first became Mid-States' general agent in California, (b) that he used premium funds prior to September 1, 1951 to pay operating expenses and, in some instances, commissions to sub-agents, (c) that Mid-States did not audit his books of account until after the events complained of in this action and did not supervise the operations of his agency, except as to underwriting procedures, (d) that Lotz' combined expenses and sub-agents' commissions on the business written for Mid-States amounted to over 40%, Mid-States' retained premium was 14%, and Lotz' loss ratio was between 64.65% and 68.51%, and that Mid-States urged him to write more business for it (Finding VII, R. 124-125). Throughout the court's opinion and in its findings it completely disregarded the fiduciary relationship between Lotz and Mid-States with respect to all aspects of his agency other than the accounting for premiums collected. It is submitted that the undisputed evidence clearly refutes these findings and vitiates the conclusions of the trial court.

The record shows that Lotz started in the life insurance business in 1923 in Sioux City, Iowa, as a direct agent and that he had been engaged in the casualty insurance business in California since 1944 (R. 1041); that he first became general agent for Mid-States in May, 1947, and continued to act for it in that capacity until the termination of his agency in January, 1952; that he wrote principally fire and casualty insurance (R. 621, Plaintiff's Exhibits 1 and 2, R. 415); and that he became general

agent for American Fidelity in 1950 and continued to act as such until the termination of such agency on August 22, 1951 (Plaintiff's Exhibits 17 and 30, R. 456-460, 639).

Lotz was sometimes a week or two late in making his payments to Mid-States (R. 685), but all amounts due it were paid in full during the entire four years of his agency prior to August, 1951 (R. 706). He never told Cass (Executive Vice-President of Mid-States until the latter part of 1950) or Hatfield (General Manager of Mid-States following the termination of Cass' employment) of any "invasions" of funds in his agency accounts (R. 688). Cass visited the agency from time to time and Lotz made his records available to Cass (R. 690). Mid-States was licensed in 28 States and Hatfield tried to call on its agents at least twice a year (R. 183). Lotz' business increased in 1948 and 1949 and was getting better. In 1948 Mid-States paid Lotz $24,117.00 in cash as earned commissions; in 1949, $48,862.78, in 1950, $70,685.02, and in 1951, he received by way of cash and credit to his account $31,704.00 (R. 463, 706). In 1950, Lotz' average monthly premium volume was between $14,000 and $15,000 a month (R. 188).

It is significant that during that entire period Lotz never defaulted in any of his obligations to Mid-States, and that the record is devoid of any evidence of any wrongful conduct on Lotz' part during those years. It is further significant that from January, 1951 to August, 1951, by far the greatest portion of the business written by Lotz was for American Fidelity (R. 593, Plaintiff's Exhibit 23, page 13). On August 13, 1951 Lotz owed Mid-States approximately $30,000 on business written for it and he owed American Fidelity approximately $240,000 on business written for it (R. 118, Finding III; R. 355, 732, 762-763). He wrote almost no insurance for Mid-States in April, none in May, approximately $32,000 in

June and none in July, 1951. Under Lotz' first contract with Mid-States he was given a credit period of 60 days, which was later increased to 75 days for a period of two months, and then reduced to 60 days under the contract of September 1, 1951 (R. 316-317, Plaintiff's Exhibit 1, Def's. Exhibit C).

Prior to Lotz' appointment as general agent for American Fidelity, the latter obtained a credit report on Lotz, and Mr. Sudekum, Executive Vice-President of American Fidelity, went to Oakland in April, 1951 and made inquiry about the operations of Lotz' agency, as the result of which he recommended to Mr. Markell, Vice-President of American Fidelity, that a 75 day credit period under his agency contract be given Lotz by American Fidelity (R. 824; Plaintiff's Exhibit 34, R. 828). Cass, who at that time was no longer employed by Mid-States, but was acting as a special representative for American Fidelity in the appointment of agents for it, arranged Lotz' appointment as agent for American Fidelity (R. 891-892). Hart admitted that American Fidelity knew that Lotz had established an enviable record with Mid-States (R. 828-829).

Despite the fact that the admitted relationship between Mid-States and Lotz was that of principal and agent, and the undisputed evidence of Lotz' faithful performance of his duties prior to August, 1951, the court found that the course of dealing between the parties disclosed a method of handling the Lotz agency which was contrary to a trust relationship (R. 113). It is submitted that this inference or conclusion from the evidence in the record is clearly erroneous.

Lotz' duty to Mid-States with respect to premiums collected on insurance written for Mid-States is specifically covered by Section 1730 of the California Insurance Code, which provides that:

> "All funds received by any person acting as an insurance agent, broker, or solicitor, life agent of any

type, life analyst, surplus line broker, special lines surplus line broker, motor club agent or bail agent or solicitor, as premium or return premium on or under any policy of insurance or undertaking of bail, are received and held by such person in his fiduciary capacity. Any such person who diverts or appropriates such fiduciary funds to his own use is guilty of theft and punishable for theft as provided by law.''

In addition, the specific contractual arrangement between Lotz and Mid-States as created and evidenced by the agency agreement of September 1, 1951 (Plaintiff's Exhibit 2, R. 415) provides that all premiums collected by Lotz on insurance written for Mid-States constituted trust funds. The previous agreements between Lotz and Mid-States did not so provide. Obviously the September 1, 1951 agreement was intended to, and, as a matter of law did, change any previous arrangement between them with respect to the treatment of premiums collected and therefore, as a matter of law, no course of conduct which existed prior to the agreement of September 1, 1951 can be held to vary the specific terms of the later agreement. The court erred in applying to the relationship of the parties with respect to premiums collected by the agent after September 1, 1951, the course of conduct which existed prior to that date. There is no evidence whatsoever in the record to indicate that Mid-States' course of conduct subsequent to September 1, 1951 was in any way at variance with the statutory provisions and the specific provisions of the agency agreement of September 1, 1951 that all premiums collected by Lotz constituted trust funds. Accordingly, the findings of the court that Mid-States' conduct was largely responsible for the losses incurred by it because of Lotz' diversion of premiums collected on Mid-States' business to American Fidelity is clearly erroneous as a matter of law and does not depend in any respect upon the court's opinion as to the credibility of any witness.

In any event, the relationship between Lotz and Mid-States with respect to premiums collected certainly could not, and did not, abrogate the fiduciary relationship of Lotz to Mid-States in respect of all other aspects of his agency.

It is well settled that an agent is a fiduciary as to his principal with respect to matters within the scope of his agency. The fiduciary duties of an agent demand the same obligations of undivided service and loyalty that are imposed upon a trustee in favor of his beneficiary. The dominant characteristic of a fiduciary relationship is the duty of the fiduciary to act solely in the interests of the person with whom he occupies such a relationship. The agent must make a full disclosure to his principal of all the facts surrounding any transaction within his agency that might affect the decision of his principal, and owes a duty to deal fairly with his principal.

This rule is stated in full in *Mechem on Agency,* Second Ed., Sec. 1207 as follows:

> "It is always the duty of an agent * * * to fully inform the principal of all facts relating to the subject matter of the agency which come to the knowledge of the agent, and which it is material for the principal to know for the protection of his interests. * * * As has been already seen, it is absolutely essential, when an agent undertakes to sustain dealing with his own principal, that it shall appear that the agent frankly and freely gave to his principal full information respecting, not only the agent's relation to the contract, but also, the various conditions respecting time, value, situations, condition and the like, which may fairly be deemed to be material in determining upon the desirability of entering into the contract. But even where the agent is not personally interested in the contract, his duty to give the principal full information of all the material facts relating to the transaction, which are within his knowledge, still exists. A

failure to perform this duty, while not necessarily rendering transactions with third persons voidable, as it would do if the agent were himself personally interested, will still make the agent liable to the principal for losses which he has proximately sustained thereby. * * *"

California Civil Code, Sec. 2230.

Restatement of the Law of Agency, Secs. 13, 392.

In *Rattray* v. *Scudder,* 28 Cal. 2d 228, 169 P. 2d 371 (1946), the court reversed an order of the trial court which had issued a writ of mandamus commanding the defendant to set aside an order revoking plaintiff's license as a real estate broker. The court said:

"The law of California imposed on * * * the real estate agent, the same obligation of undivided service and loyalty that it imposes on a trustee in favor of his beneficiary. Violation of his trust is subject to the same punitory consequences that are provided for a disloyal or recreant trustee. *King* v. *Wise,* 43 Cal. 628. *Langford* v. *Thomas,* 200 Cal. 192, 196, 252 P. 602, 603. Such an agent is charged with the duty of fullest disclosure of all material facts concerning the transaction that might affect the principal's decision. Civ. Code, Sec. 2230; *Langford* v. *Thomas, supra,* 200 Cal. at Page 197, 252 P. 602, 603; *Williams* v. *Lockwood,* 175 Cal. 598, 601, 166 P. 587; *Fechenscher* v. *Gamble,* 12 Cal. 2d 482, 495, 85 P. 2d 885; *Curry* v. *King,* 6 Cal. App. 568, 575, 92 P. 662; *Silver* v. *Logue,* 127 Cal. App. 565, 571, 16 P. 2d 183; *Jolton* v. *Minster, Graf & Co.,* 53 Cal. App. 2d 516, 522, 128 P. 2d 101; *Baird* v. *Madsen,* 57 Cal. App. 2d 465, 476, 134 P. 2d 885."

In *Faultersack* v. *Clintonville Sales Corporation,* 253 Wis. 432, 34 N. W. (2d) 682 (1948) the defendant, an auctioneering corporation, sold plaintiff's farm to a purchaser whom it financed. Although defendants' president, who acted as auctioneer at the sale, knew of the agreement be-

tween it and the buyer, the plaintiff was not informed of the arrangement prior to the sale. There was no showing of fraud or damages. The sale price was below that stipulated by the seller, yet he was present when the farm was knocked down and he knew to whom it was being sold. The defendant tendered the net proceeds of the sale, less its commission, to the seller, who demanded that the total commission be refunded. The court held for the seller, stating that:

> "An agent is in a fiduciary relation to its principal, which results in a duty to disclose every material fact relating to the agency. Where there is a non-disclosure of a material fact relating to the agency, though there is a showing of neither fraud nor damages, the agent forfeits the right to any commission. The reason is that the principle is preventive rather than curative."

In *In Re Arbuckle's Estate,* 98 Cal. App. 2d 562; 220 P. 2d 950 (1950), the court said:

> "* * * The acts of an agent are judged with almost the same strictness as those of a trustee. *Williams* v. *Lockwood,* 175 Cal. 598, 601, 166 Pac. 587. A trustee is not permitted to use or deal with trust property for his own profit or for any other purpose unconnected with the trust in any manner. (Civ. Code, sec. 2229.) 'A violation of duty on the part of a trustee is treated as a fraud upon the beneficiary (Civ. Code, sec. 2234), and a violation of duty on the part of an agent should be treated in the same manner. Civ. Code, sec. 2322; *Sterling* v. *Smith,* 97 Cal. 343, 32 Pac. 320. Under said section 2322, an agent may not do any act which a trustee is forbidden to do.' *Darrow* v. *Robert A. Klein & Co., Inc.,* 111 Cal. App. 310, 316, 295 Pac. 566, 568; *Elam* v. *Arzaga,* 122 Cal. App. 742, 746, 10 P. 2d 850."

It is submitted that in the instant case Lotz clearly violated his fiduciary duties to Mid-States. The undisputed

evidence in the case shows that at the time Lotz met with Hatfield and Titus in Chicago following the New York meeting he failed to disclose his financial condition and the imminent termination of his agency for American Fidelity because of his inability to pay it what he owed (R. 205-207, 654, 718-720). He was advised by Hart not to contact Cass while in Chicago because Cass might contact Mid-States (R. 654, 656). The court concluded that Lotz was "a very confused and mentally upset person * * *" (R. 108); that because of his mental and physical condition he was influenced by Smead; and that Lotz was an imprudent, ill-advised businessman who did not know very much about the internal operations and problems of his agency. The court further concluded that Lotz did not intend to conduct himself fraudulently in trying to save his business and therefore was not guilty of a breach of his fiduciary obligations to Mid-States (R. 108-110; Finding XIV, R. 129-135).

However, the undisputed evidence shows that Lotz was familiar with the conditions and workings of his agency, although he may have left many operating details to Smead. He helped Oldberg get his bearings regarding the business of the agency (R. 692); and he knew about the rates on insurance written (R. 693). Lotz personally negotiated his new agency contract of September 1, 1951 with Mid-States (R. 631). He met with Hart and Feller in Oakland on August 22, 1951 and discussed his indebtedness to American Fidelity with them (R. 635). He was familiar with his check made payable to American Fidelity that had been returned for non-payment prior to the meeting in New York, and with his indebtedness to American Fidelity, arising out of a prior reinsurance deal between Public Service Insurance Company and American Fidelity (R. 625-626, 631-632). He discussed the Public Service Rewrite with Hart and Feller while they

were in Oakland (R. 635) and he was generally familiar with what went on following his meeting with them on August 22, 1951 (R. 636). He knew the Public Service Rewrite checks made payable to Mid-States had been deposited in his trustee account (R. 637), and that checks representing substantially all the proceeds thereof were thereafter deposited in American Fidelity's account in Oakland (R. 636-638). He personally signed four of the checks on his trustee account made payable to American Fidelity which represented substantially all the premiums received for Mid-States' account on the Rewrite (R. 635-638). He personally discussed his lack of authority to endorse checks made payable to the order of Mid-States with an officer of the Anglo Bank (R. 666-671; Intervening Pl's. Exhs. 2, 3), and he corresponded with Hatfield about his lack of authority to endorse (R. 291-292; Intervening Pl's. Exh. 4). He testified that he thought he was present when Hart asked that Lotz' bookkeepers make a tab run to develop the balances due from Lotz' sub-agents and the amounts due the insurance companies, and stated that "it is probably right" that his bookkeepers developed those figures for Hart while the latter was in Oakland in August (R. 633). After August 22, 1951 Lotz maintained a private black memorandum book in which he regularly recorded the payments being made from time to time to American Fidelity on its account (R. 661-662). He wrote out a supplemental statement on December 7, 1951, took it to Santa Monica, and personally delivered it to Mr. Oldberg, and there is not one iota of evidence in the record that anyone helped him prepare it. Lotz reviewed the transactions following August 13, 1951 with Hatfield in Smead's presence following payment of American Fidelity's account in full, and Lotz concurred in most of it (R. 646). Lotz recalled Smead's writing of Plaintiff's Exhibit 11 in the agency office and was trying to write one himself which

he did not get completed (R. 649). He signed the statement on December 6 and thinks it was read over by Mead (R. 651). He knew of Smead's writing the additional statement on December 7, 1951 (R. 651, Plaintiff's Exhibit 12). He and Smead discussed the statements back and forth (R. 657). He was present when Plaintiff's Exh. 22 was prepared and after it was typed and the final corrections made, everyone present said it was a correct statement of the facts (R. 651-658).

Lotz' Insolvency.

There is no dispute in the evidence that Lotz was insolvent at the time of the New York meeting on August 13, 1951, and that his insolvency continued thereafter (Plaintiff's Exhibits 23, 25, and 27). It is clear that Lotz was unable to pay his total indebtedness to American Fidelity at that time or in the future out of funds owing Lotz on account of unpaid premiums on policies written up to that time for American Fidelity. Lotz suggested that he might be able to raise $50,000.00 by a bank loan secured by commissions earned and to be earned but he was unable to do so. The defendants American Fidelity and American Plan directed that Lotz make prompt collection of his receivables and cease writing insurance for American Fidelity (Plaintiff's Exhibit 17). As a result it was obvious to the defendants that there would be no further premium income from business written in the future by Lotz for American Fidelity.

The court stated in its opinion that no "exact knowledge" of the financial status of the Lotz agency was known when the defendants carried on the various transactions complained about (R. 108). Apparently based upon this conclusion the court found that "* * * it is not true that defendants knew on or about August 1, 1951 or at any time

prior to approximately December, 1951 that Lotz was insolvent or that he would be unable to meet his obligations to Mid-States." (Finding VIII, R. 126), and further found that owing to the condition of Lotz' books he could not tell from them at any time "with any degree of accuracy" how much he owed Mid-States or American Fidelity or any other company he represented (Finding X, R. 127). It is submitted that these conclusions are clearly erroneous. The undisputed facts show that Lotz' premium receivables on business written for American Fidelity to August 13, 1951 were substantially less than the amount he owed American Fidelity; that Lotz did not then have sufficient funds on hand to meet his obligations to American Fidelity (Plaintiff's Exhibits 25, 23 pp. 13-17; R. 592-600); that Lotz was unable to procure a loan which he desperately needed to continue in business; and that the only way American Fidelity could obtain payment from Lotz was to place its own representative in Lotz' office to ensure that all funds received, regardless of on whose business, would be paid to it, and when even that failed to generate sufficient funds, as a last resort it realized that the debt could not be paid except by cancelling a part of it through the device of shifting the offsetting liability, namely, the American Fidelity Rewrite hereinafter discussed. Lotz knew on November 27, 1951, long before the audit of his affairs had been made by Mid-States, that by August 31, 1951, he "was insolvent to the extent of approximately $100,000" (Plaintiff's Exhibit 6, R. 230). Hart admitted he knew Lotz was financially strained (R. 858), and that he "wasn't very liquid" and that by August 22, 1951 Lotz had "scraped the bottom of the barrel" (R. 870-871). It was solely because of Lotz' demonstrated inability to meet his debts as they matured that the due dates of Lotz' indebtedness to American Fidelity were advanced and Smead was hired as American Fidelity's

own direct agent to take charge of Lotz' finances and to apply all receipts to American Fidelity's indebtedness.

The trial court also refused to recognize as significant the fact that Smead, as the financial representative of American Fidelity and American Plan from the date of his appointment under the agreement made with Lotz on August 22, 1951, was thoroughly familiar with the financial condition of the Lotz agency and Lotz' insolvency, and his knowledge is, of course, the knowledge of his principal, American Fidelity, for which he acted.

The court's attention is also called to the fact that in its finding regarding the state of affairs of Lotz' books and records the trial court completely disregarded the testimony of Horton, a member of the firm of Lester, Herrick & Herrick, certified public accountants, who subsequently audited the books and records of the Lotz agency and who testified that a tape could have been run at any time, the completion of which would have taken a couple of days, which would have shown the approximate receivables and payables of the agency at that particular time (R. 613-615, 618-620). The court further ignored the written corroboration by the three former employees of the Lotz agency, including the head of the bookkeeping department, of Smead's statement that such a tape had been run and that the results were known to American Fidelity's paid agent Smead.

The Public Service Rewrite.

Lotz admitted that he discussed the Public Service Rewrite with Hart and Feller when they were in Oakland on August 22, 1951 (R. 635). We have previously reviewed Lotz' admissions with respect to his further participation in this Rewrite. Hart admitted that he knew about the proposed Rewrite when he was in Oakland at that time (R. 848-849), and that Lotz paid a 25% commission to

Russell and Bond, insurance agents, notwithstanding the fact that Lotz had an advance commission arrangement of only 15% with Mid-States. The Rewrite took place at a time when Lotz was insolvent and unable to pay American Fidelity what he owed it, and after his agency with it had been terminated and all American Fidelity policy forms in his office had been destroyed (R. 847-863; Plaintiff's Exhibit 29). Hart knew that the net proceeds of the Public Service Rewrite were being paid by Lotz to American Fidelity (R. 780, 804; Plaintiff's Exhibit 29). Thus, Lotz incurred an obligation to Mid-States for 85% of the premiums on the Rewrite and, although insolvent, received only 75% and paid substantially all of that to American Fidelity, thus saddling Mid-States with liability to the assureds under the rewritten policies and an uncollectible debt from Lotz, all for the benefit of American Fidelity and American Plan.

There is also no dispute in the evidence that the policies were not rewritten under Mid-States' rate chart, and that many of the assureds were sub-standard risks (Plaintiff's Exhibits 3 and 4; R. 198-203). Lotz had never before engaged in a rewrite transaction of this kind on behalf of Mid-States.

The first check received on account of the Public Service Rewrite was made payable to the order of Lotz but payment was stopped and a new check issued to the order of Mid-States. All subsequent checks were issued to the order of Mid-States. Lotz nevertheless endorsed Mid-States' name to the checks and deposited them in his own account, and he did this notwithstanding the fact that he had written Hatfield requesting authority to endorse checks so made payable, that he went to the Anglo Bank on August 30 or August 31, 1951 for the purpose of open-

ing a trustee account (R. 668), and told the bank that he was going to deposit in his account checks made payable to Mid-States and other companies, and that when Anglo asked him if he had authority to endorse checks made payable to Mid-States, he told it he had such authority (R. 670), and that Lotz subsequently received two letters from Mid-States in which authority to endorse checks so made payable was refused (Intervening Plaintiff's Exhibits 1, 2, 3 and 4, R. 287-292). Lotz did not discuss the Public Service deal with Hatfield until after it was completed (Plaintiff's Exhibit 31, R. 654, 656). Lotz' letter to Mid-States dated September 8, 1951 (Intervening Plaintiff's Exhibit 4, R. 292-293) is also significant. Although it was written two and a half weeks after the termination of Lotz' agency with American Fidelity, Lotz made no disclosure of that fact to Mid-States but told them a misleading half-truth—that "We are not sending the American Fidelity & Casualty Company any business whatsoever—you are getting it all."

Lotz made no disclosure of any of the facts to Mid-States prior to effecting the rewrite. Yet, the Court not only completely disregarded this undisputed evidence but, in spite of it, held that Lotz had not breached his fiduciary duties of fair dealing and full disclosure to Mid-States. Lotz and his employee Smead were acting for adverse parties at the time; yet he made no disclosure of any facts to Mid-States which would permit it to exercise its judgment with respect to this transaction. In further breach of his fiduciary duties, he transferred to American Fidelity substantially all of the premiums received from the Rewrite in partial satisfaction of his debt to it, with the full knowledge of American Fidelity of the source of the payment and of Mid-States' right to said funds.

We call the Court's attention especially to Plaintiff's Exhibits 3 and 4, dated September 28, 1951 and October

8, 1951, respectively, which clearly confirm Hatfield's testimony as to when he first received the dailies respecting this transaction.

The American Fidelity Rewrite.

This was the second transaction in which Lotz and his employee Smead dealt on behalf of adverse parties and with respect to which he failed to disclose the facts to Mid-States until long after the transaction was completed and Mid-States had begun to investigate the defendants' acts. The evidence regarding this transaction is undisputed. After the premiums on the Public Service Rewrite had been received by Lotz, and substantially all of them had been paid over to American Fidelity, and all available funds from other sources had been paid to it, there remained owing to American Fidelity from Lotz a balance of approximately $61,000. There were then no other funds available, and Hart and Smead arranged this transaction under which American Fidelity policies with unexpired premiums in the amount of approximately $61,000 would be cancelled and rewritten in Mid-States (Plaintiff's Exhibit 29, p. 18, message of October 30, 1951, p. 19; message of October 31, 1951). Hart admitted that all or substantially all of the premiums had already been paid by the assureds and that Lotz had told him he didn't have the money to pay American Fidelity these premiums (R. 893). Lotz admitted that he knew that most of the premiums had already been paid by the assureds (R. 663). It is significant that under this transaction Lotz could not have profited by way of any advance commission because Hatfield told him that none would be allowed on this deal (Plaintiff's Exhibit 29, Teletype Message dated October 31, 1951; Plaintiff's Exhibit 5, R. 218).

The sole effects of the transaction were (a) to reduce the unpaid balance of Lotz' indebtedness to American

Fidelity by the amount of the Rewrite and to transfer Lotz' obligation for the premiums to Mid-States while Lotz was insolvent and knew it, and (b) to place the liability to the assureds on Mid-States.

The Rewrite was effected following a telephone conversation between Hart and Hatfield. There is no dispute whatsoever regarding the statements made during this telephone conversation (Plaintiff's Exhibit 5, R. 215-223). Yet the Court stated in its opinion that it gave little weight to the argument that Hart's words were fraudulently intended, and further stated that Hatfield did not rely on Hart's representations (R. 112). The Court also found that the "defendants" did not know at the time the agreement was entered into that Lotz would be unable to pay Mid-States the premiums on the insurance to be so rewritten (Finding XII, R. 128); that "defendants" were not guilty of any fraudulent concealment or affirmative misrepresentations in respect to the transaction, and that Mid-States did not suffer any deception in respect thereof and did not rely thereon in entering into the agreement (Finding XIV, R. 133). It is submitted that there is no basis in the record for these conclusions of the trial court. There were four distinct misrepresentations by Hart, only two of which we deem it necessary to consider in view of their obviously fraudulent content:

> (1) In replying to the following question by Hatfield, "You didn't kick them out, I know that", Hart replied, "* * * no, we didn't kick them out. Of course not" (Plaintiff's Exhibit 5, R. 222). Hart did not tell Hatfield that Lotz' contract with American Fidelity had been cancelled (R. 893). We do not deem it necessary to argue the question of whether or not Lotz' contract was terminated at its request or his. The preparation of Plaintiff's Exhibit 16 by Hart and Feller (American Fidelity's attorney) and the appointment of Smead

as its representative (Plaintiff's Exhibit 18) are sufficient answers to that question. It would be difficult indeed to imagine a termination by mutual consent with the drastic and extreme penalties such as were imposed upon Lotz in Plaintiff's Exhibit 17. He was stripped of every authority previously given him, the time limit for payment of his entire indebtedness to American Fidelity was fixed at September 15, 1951 (a period of three weeks) in lieu of the 75 days provided in his contract, all American Fidelity policy forms in his office had been destroyed (R. 895), and even the handling of his money was turned over to Smead as agent for American Fidelity and American Plan. Under any construction, Lotz' agency for American Fidelity had been cancelled and under the authorities hereinafter discussed Hart clearly misrepresented that fact. In spite of its great significance, the trial court concluded that Mid-States did not rely on the misrepresentation.

(2) Hart told Hatfield that Lotz had not paid the premiums on these policies to American Fidelity, in response to which Hatfield asked Hart how old the business was. Hart replied, "September." Hatfield repeated, "September", and Hart stated "September, and there's some August. But you see the September business is not due under our contract—we have 75 days * * * Actually, until December 15." (Plaintiff's Exhibit 5, R. 216). This was a deliberate and fraudulent misrepresentation. Lotz' agency from Mid-States had been cancelled in August and all policy forms had been destroyed by Hart himself when he was in Lotz' office in August. It was accordingly impossible for any of the business to have been written in the month of September. By this statement Hatfield was led to believe that Lotz was current in his account, since the premiums for September business were not due American Fidelity until December. The misrepresentation had the further effect of allaying any possible concern that Hatfield might have regarding Lotz, and inferred that the latter was still an agent of

> American Fidelity and was continuing to write business for it as recently as the preceding month. In addition, the premiums on this business were already in arrears (R. 893).

It is further significant that (a) Hart was very careful before calling Hatfield to arrange to have the telephone conversation recorded but that he did not inform Hatfield of the recording, and (b) Hart was insistent in his conversation that Hatfield wire his acceptance of the proposal and state in the wire that Mid-States would look to Lotz for the premiums (R. 218), all without making the slightest suggestion to Hatfield of Lotz' financial condition.

Whether or not Hart intended to deceive Mid-States is, of course, an inference or conclusion drawn from the undisputed facts by the trial court and, as has been pointed out above, this court is not bound by such inference or conclusion but may make its own determination. There is no dispute in the record as to the exact statements made by Hart or that these statements were untrue. Hart acknowledged that his statement about when "the business was written" was not true (R. 896-897). He attempted to justify his statement about not having "kicked out" Lotz by saying the latter's agency was terminated by mutual agreement (R. 894-895).

It is the universal rule that where one undertakes to speak either voluntarily or in response to inquiry, he must make a fair and full disclosure and conceal no facts within his knowledge which materially qualify those stated. Thus, in *Rattray* v. *Scudder,* 28 Cal. 2d 228, 169 P. 2d 371 (1946), the court, in referring to the duty of disclosure, stated that:

> "Even if plaintiff had not been Humston's broker and under no fiduciary duties, once he discussed the question whether a higher price was obtainable he had to 'speak the whole truth, and not by partial sup-

pression or concealment make the utterance untruthful and misleading'. *American Trust Co.* v. *California, etc. Ins. Co.,* 15 Cal. 2d 42, 65, 98 P. 2d 497, 508."

In *Wells* v. *Zenz,* 83 Cal. App. 137, 256 Pac. 484 (1927), the question involved the making of a false affidavit as to the alleged unknown whereabouts of the defendant. The court said at page 485:

> "Fraud is a generic term which embraces all the multifarious means which human ingenuity can devise and are resorted to by one individual to get an advantage over another. No definite and invariable rule can be laid down as a general proposition defining fraud as it includes all surprise, trick, cunning, dissembling and unfair ways by which another is deceived. *Armstrong* v. *Wasson,* 933 Okla. 262, 220 Pac. 643. The statutes of California expressly provide that the suppression of a fact by one who gives information of other facts likely to mislead for want of communication of the fact concealed is deceived (Civ. Code, Sec. 1710), and any other act fitted to deceive is actual fraud (Civ. Code, Sec. 1572)."

The court said at page 486:

> "As has been said, fraud may be committed by the suppression of the truth as well as by the suggestion of falsehood. It may consist in suppression of that which it is one's duty to declare as well as in the declaration of that which is false. 12 Cal. Jur. 770."

In the above case it appeared that while the affiant actually did not know the whereabouts of the defendant, affiant did know that a third person knew the defendant's whereabouts, although that third person did or would probably not give affiant that information.

In *Kuhn* v. *Gottfried,* 103 Cal. App. 2d 80, 229 P. 2d 137 (1951), there was a suit by the purchaser of a house against the seller on the grounds of fraud because of non-disclosure

that the house purchased was infested with termites. The court said:

> "Concealment may constitute actual fraud where the seller knows of facts which naturally affect the property which he knows are unknown to the buyer. *Dyke* v. *Kaiser,* 80 Cal. App. 2d 639, 192 P. 2d 344; *Rogers* v. *Warden,* 20 Cal. 2d 286, 125 P. 2nd 7; *Boas* v. *Bank of America,* 51 Cal. App. 2nd 532, 125 P. 2d 620. The cases cited are also authority for the proposition that where one is under no duty to speak but yet undertakes to do so either voluntarily or in response to inquiry, he must make a fair and full disclosure and conceal no facts within his knowledge which materially qualify those stated including any facts which affect the desirability of the property to be sold."

The misrepresentations made by Hart were not misunderstood or ambiguous terms. They were definite specific statements of facts known to Hart. Under all the circumstances under which the conversations took place: the careful and secret preparation for recording, the continued insistence upon a telegram of acceptance specifying that Mid-States would look to Lotz solely for the premiums, Hart's care to add that "some" of the business was written in August after he had twice specified that it had been written in September and Hatfield had indicated a little surprise at that, Hart's specification that the premiums were not due until December 15 "under our contract" although he knew full well that the contract had been terminated and that payment from Lotz by September 15, 1951 had been insisted upon, his reference to the 15% advance commission that Lotz had hoped to receive thereon when he already knew that the same had been refused by Mid-States, his purported examination of American Fidelity's records as to the status of Lotz' loss ratio and his misstatement with respect thereto, all show clearly that

Hart intended to and did, by deliberate misstatements, half truths and concealment lead Mid-States to believe that Lotz' contract had not been terminated, that Lotz was current in his obligations and that Lotz, and not American Fidelity, had initiated and desired the rewrite.

As the court said in *Hayter* v. *Fulmore,* 92 Cal. App. 2d 392, 206 P. 2d 1101 (1949), at page 398:

> "A fraudulent intent to deceive another may be inferred from a material statement which is made with full knowledge that it is false. When one deliberately makes false representations of material facts, knowing them to be untrue, the law supplies the fraudulent intent to deceive. (*Boas* v. *Bank of America National Trust & Savings Assn.*, 51 Cal. App. 2d 592, 598 (125 P. 2d 620); 37 C. J. S. 259, Sec. 22.)"

Accordingly, the court's finding that Hart did not intend to deceive or defraud is erroneous as a matter of law and is not even a permissible inference to be drawn from the facts. As stated in the Restatement of the Law of Torts, Section 526:

> "A misrepresentation in a business transaction is fraudulent if the maker
>
> > "(a) knows or believes the matter to be otherwise than as represented, or
> >
> > "(b) knows that he has not the confidence in its existence or non-existence asserted by his statement of knowledge or belief, or
> >
> > "(c) knows that he has not the basis for his knowledge or belief professed by his assertion."

Actually, of course, as the *Hayter* case itself points out, even if these misstatements were made as the result of negligence or carelessness, the defendant American Fidelity would be liable to Mid-States for constructive fraud.

The finding that the statements were not relied upon by Hatfield or by Mid-States in entering into the contract with

American Fidelity for the rewrite is obviously based upon the court's statement in its opinion (R. 112) that "taking into consideration the fact that Hart and Hatfield were both experienced business executives in large competing insurance companies it is the court's view that Hatfield did not rely on Hart's representations." There is no evidence whatsoever in the record that Hatfield did not rely on Hart's misrepresentations; the finding that he did not is completely unsupported and is clearly erroneous unless under the law Hatfield was not justified in relying upon a specific statement of fact made by a competitor in negotiating a business transaction. But under the law Hatfield *was* justified in so relying. As the court said in *Anderson* v. *Thacher,* 76 Cal. App. 2d 50, 172 P. 2d 533 (1946) at page 70:

> "The possible but antiquated authority that one must assume that everyone with whom he has a business transaction is a rogue and act accordingly will not receive judicial approval. The courts rather will hold that one can act upon the presumption that there exists no intention to defraud him. (*Tidewater Southern Ry.* v. *Harney,* 32 Cal. App. 253, 260, 162 Pac. 664.)"

As the United States Court of Appeals for the Fourth Circuit said in *Bishop* v. *E. A. Strout Realty Agency, Inc.,* 182 F. 2d 503 (1950) at page 505:

> "There is nothing in law or in reason which requires one to deal as though dealing with a liar or a scoundrel, or that denies the protection of the law to the trustful who have been victimized by fraud."

The court, in that case, quoted with approval Section 540 of the Restatement of the Law of Torts, as follows:

> "The recipient in a business transaction of a fraudulent misrepresentation of fact is justified in relying upon its truth, although he might have ascertained the falsity of the representation had he made an investigation."

As is stated in 12 Cal. Jur., Sec. 34, and quoted in *United States National Bank* v. *Stiller,* 216 Cal. 324, 14 P. 2d 78 (1932):

> "Every contracting party has an absolute right to rely on the express statement of an existing fact the truth of which is known to the opposite party and unknown to him, as the basis of a mutual agreement; and he is under no obligation to investigate and verify statements to the truth of which the other party to the contract, with full means of knowledge, has deliberately pledged his faith."

The fact that Hart was the head of a supposedly reputable insurance company and experienced in insurance accounting was all the more reason why Hatfield or anyone else would and should assume that representations made by him would be truthful and not false. Indeed, Hart posed as a friend of Hatfield's by saying that he did not want to proceed unless he got Hatfield's okay "because you and I have always worked close together." Under the circumstances the law presumes that Hatfield and Mid-States did rely on Hart's misrepresentations unless there is affirmative proof to the contrary, which is not here present. The rule is stated in the Restatement of the Law of Contracts, Section 479:

> "Where fraud or misrepresentation is material with reference to a transaction subsequently entered into by a person deceived thereby, it is assumed in the absence of facts showing the contrary that it is induced by the fraud or misrepresentation."

That the deliberate misrepresentations were intended to, and did, deceive Mid-States to its damage is clear. As the court in *Gibbons* v. *Brandt,* 170 F. 2d 385 (C. C. A., 1947), said, in quoting from *The People* v. *Gilmore,* 345 Ill. 28, 46, 177 N. E. 710, 717:

> "Fraud in its generic sense, especially as the word

> is used in courts of equity, comprises all acts, omissions, and concealments involving a breach of legal or equitable duty and resulting in damage to another. * * * It may consist in * * * the positive assertion of a falsehood, or in the creation of a false impression by words or acts, or by any trick or device, or in the concealment or suppression of the truth, or in both a suggestion of falsehood and a suppression of truth together. *Bundesen* v. *Lewis,* 291 Ill. App. 83, 9 N. E. 2d 327, 333. We find no authority requiring that the representation must have been of such character as to amount to perjury. A single word, even a nod or a wink or a shake of the head or a smile or gesture intended to induce another to believe in the existence of a non-existing fact may be fraud. *Walters* v. *Morgan,* 3 De G. F. & J. 718, 64 Eng. Ch. 718, 45 Eng. Reprint 1056; *Turner* v. *Harvey,* 1 Jac. 169, 4 Eng. Ch. 169, 37 Eng. Reprint 814; *Wicker* v. *Worthy,* 51 N. C. 500; 26 C. J. 1071; 37 C. J. S. Fraud, Sec. 15. Since there is no difference in the natural effect on the mind of one deceived, whether the deceiver uses words, writings, or symbols, it follows that there is no difference in the legal consequence and the deceiver is liable no matter what means he employs. *Morley* v. *Harrah,* 167 Mo. 74, 66 S. W. 942. In other words, if deception is accomplished, the form of the deceit is immaterial. The impelling question is 'did it produce upon the mind a false impression conducive to action?' "

The answer in this case is an unqualified "Yes". It is submitted that the trial court's conclusion to the contrary is clearly erroneous.

Smead's Part in the Transactions.

The trial court stated in its opinion that "In the absence of a showing of fraudulent intent on the part of the defendants the act of appointing Smead does not appear overly significant to the decision in this case." The court further stated that very little credence could be given to

Smead's testimony, and then obviously concluded that his written statements, made immediately following the first knowledge of Mid-States of the events that had occurred subsequent to August 13, 1951 and long prior to the trial, should be given no effect.

Smead signed four statements (Plaintiff's Exhibits 11, 12, 13, 22 and 31) to which reference has already been made. The first statement was also signed by Lotz, and the acknowledgment of Smead's signature thereon taken by Lotz' attorney, Mead (R. 928-930). Neither Lotz nor Mead ever denied the truth of these statements. Lotz also wrote out and signed a separate statement (Plaintiff's Exhibit 31, R. 653-655). Lotz' own admissions corroborated many of the facts contained in the statements. Mead, notwithstanding the fact that he was Lotz' attorney, and was representing Smead as Lotz' employee, until the end of 1951 and was thoroughly familiar with Lotz' affairs, testified that he never read any of the statements (R. 930-931, 939) although he knew, of course, they had been given. His thorough familiarity with Lotz' affairs is evidenced by the further fact that Lotz' proposal to Mid-States for the continuance of his agency, contained in Lotz' letter to Mid-States dated November 27, 1951 (Plaintiff's Exhibit 6, R. 230, 511), which acknowledged Lotz' violation of his agency contract, was prepared in Mead's office and read by him, and that Mead prepared a so-called "target plan" which he submitted to Mid-States and which he said he believed would enable Lotz to eventually pay his indebtedness to Mid-States and continue his operations as an insurance agent (R. 1006-1011, 1013-1017, 1024, 1028-1035).

The trial court also obviously disregarded the fact that Smead's statement of December 18, 1951 (Plaintiff's Exhibit 22) was witnessed by Miss Faye Roach, formerly head bookkeeper of the Lotz agency, Miss Martha Keyes,

formerly secretary to Lotz and Smead, and Miss Janice S. Howard, formerly a bookkeeper for Lotz.

The weight and effect to be given to these various, almost contemporary, written statements can be determined by this court fully as well as by the trial court. The accuracy and the credibility to be given them does not depend upon the demeanor of Smead on the witness stand or any presumed advantage which the trial court had by observing Smead. Smead admittedly made contradictory statements. That he had lied in the course of prior proceedings concerning some of these matters is established by the record and does not depend upon the trial court's observance of his demeanor. The sole question is whether more weight should be given to Smead's oral denial of these statements while he was in the employ of American Fidelity than to his prior almost contemporaneous written statements. This Court of Appeals not only can pass upon the weight to be given this evidence as well as the trial court, but under the decisions is impelled to make its own determination.

This rule has been followed by this court in *Smyth* v. *Barneson,* 181 F. 2d 143 (C. A. 9, 1950) in which this court stated, at page 144:

> "In determining this point we consider all of the evidence, giving the written evidence the weight we deem it entitled to *de novo* and applying the oral evidence with 'due regard * * * to the opportunity of the trial court to judge of the credibility of the witnesses.' "

In *Carter Oil Co.* v. *McQuigg,* 112 F. 2d 275 (C. C. A. 7, 1940), the court stated, at page 279:

> "Where the question is one of veracity it is clear that the appellate court should give controlling weight to the trier of fact who saw and heard the witnesses. This is well established. Where the testimony con-

sists of documentary evidence and depositions, the master is in no better position to determine an issue of fact than a reviewing court. The District Court's finding on such evidence is likewise subject to free review unaffected by presumptions which ordinarily accompany their findings on controverted issues."

It must also be remembered that throughout this period Smead was the direct compensated employee of American Fidelity and that all his acts performed pursuant to such employment are binding upon defendants American Fidelity and American Plan for whom he acted. His employment is evidenced by the written instrument dated August 22, 1951 (Plaintiff's Exhibit 17, R. 456-460) and this court can, under the doctrine above referred to, interpret as well as the trial court the scope of the agency thereby created. Under these circumstances it is clear that the trial court erred when it concluded that the agency was solely with respect to collection of premiums owed on American Fidelity insurance and the payment thereof to American Fidelity.

It is uniformly held that where the trial court's findings are in effect findings as to the legal effect of documents or transactions rather than findings which resolve disputed facts, the Court of Appeals is free to make its own determination as to the legal conclusion to be drawn. Thus, the construction of a contract is within the competence of the Court of Appeals.

Crosley Radio Corp. v. *Dart,* 160 F. 2d 426 (C. C. A. 6, 1947).

Continental Illinois National Bank and Trust Company of Chicago v. *Ehrhart,* 127 F. 2d 341 (C. C. A. 6, 1942).

Nee v. *Main Street Bank,* 174 F. 2d 425 (C. A. 8, 1949).

The truthfulness of Smead's written statement is fully corroborated by the events which actually transpired immediately following the New York meeting of August 13, 1951.

Lotz' Responsibility For His Own Acts.

That the judgment in this case is based in large part, if not entirely, upon a misapprehension of the correct rule of law applicable to the facts, is clearly demonstrated by the reference by the trial court in the Findings and in its Opinion to the "facts" that Lotz was a sick man and an inefficient agent, that his bookkeeping was not kept up to date and that Mid-States did not investigate Lotz' activities more carefully. It is apparent from these references that the court assumed that if a breach of the fiduciary duty of Lotz as agent was due to his illness or his negligence or inattention to business, the breach was excusable and could not be the basis of a recovery by the plaintiff even of money admittedly owed it by the agent. The law is, of course, quite otherwise. Not only does illness or preoccupation with other matters or negligence not excuse a breach of trust; it is in and of itself, in a professional compensated agent, a breach of trust. The rule is succinctly stated in 2 Am. Jur. 220:

> "An agent owes to his principal the use of such skill as may be required to accomplish the object of his employment; if he omits to exercise reasonable care, diligence, and judgment as the result of which failure his principal is damaged, he may be held responsible for such damage. If one who undertakes the business of another is capable of managing it and neglects to do so with due care, he is answerable; if he is not capable, he is still answerable, for he ought not to have engaged to do that which he could not perform. Even where the principal is habitually negligent in attending to his own interests, such negligence forms

no excuse for similar negligence on the part of his agent."

In *Myerson* v. *New Idea Hosiery Company,* 217 Ala. 153, 115 So. 94, 55 A. L. R. 1231 (1927), the court recognized this principle as applicable even to a gratuitous agent.

As stated in *Allen* v. *Suydam,* 20 Wendell 321, at page 331, 32 Am. Dec. 555 (1838):

> "It is the duty of a faithful agent to do for his principal, whatever the principal himself would probably have done, if he was a discreet and prudent man. Even where the principal is habitually negligent in attending to his own interests, it forms no excuse for similar negligence on the part of his agent."

In this case, of course, there is no claim whatsoever that Mid-States was itself negligent in attending to its business. The sole "negligence" adverted to by the court was merely that Mid-States did not continually investigate Lotz' books and his method of handling premiums collected. Obviously, there is no duty on a *cestui que trust* to investigate his fiduciary to ascertain whether or not the fiduciary is performing his obligations properly; the beneficiary has a right to assume that the fiduciary is acting properly.

As the court said in *American Trust & Banking Co.* v. *Boone,* 102 Ga. 202, 29 S. E. 182, 40 L. R. A. 250 (1897):

> "Every person is presumed to have the intention of discharging whatever duty the law may cast upon him. It is therefore presumed that a trustee will faithfully administer the trust. * * *"

In this case, Lotz understood the duties of a general insurance agent. He fulfilled these duties with at least ordinary skill, as is shown by the fact that after he had represented Mid-States in that capacity for some years,

he was employed by American Plan and American Fidelity in a similar capacity. As the Supreme Court of Maryland said in *Baltimore Base Ball & Exhibition Co.* v. *Pickett,* 78 Md. 375, 28 A. 279, 22 L. R. A. 690 (1894), in quoting with approval the Supreme Court of Pennsylvania,

> "'* * * 'where skill, as well as care, is required in performing the undertaking, if the party purport to have skill in the business, and he undertakes for hire, he is bound to the exercise of due and ordinary skill in the employment of his art or business about it, or, in other words, to perform it in a workmanlike manner. In cases of this sort he must be understood to have engaged to use a degree of diligence and attention and skill adequate to the performance of his undertaking.' * * *"

The Defendants' Responsibility for Smead's Acts.

The court stated in its opinion that Lotz was a sick and disturbed man and that the evidence disclosed that he relied very heavily on Smead's abilities (R. 111). As we have shown above, Lotz' lack of ability, if any, is not only not an excuse for his breach of his fiduciary duties but is in itself a breach of such duties. Similarly, the court clearly erred as a matter of law in ruling that because Lotz relied on Smead neither Lotz nor the other defendants were liable for the breach of Lotz' fiduciary duties occasioned by the acts of Smead. Smead was an employee of Lotz, acting in the capacity of General Manager throughout the period in question, and under well settled law the master Lotz is responsible for all the acts of his servant Smead performed within the scope or apparent scope of Smead's employment. This is true even if Smead had actually disobeyed Lotz' specific instructions, as to which there is no evidence in the record.

Thus, in *Transcontinental & W. Air* v. *Bank of America, Etc.,* 46 Cal. App. 2d 708, 116 P. 2d 791 (1941), the plain-

tiff had agreed to sell travelers checks issued by defendant's bank, and plaintiff's employee, in charge of one of its offices, appropriated the proceeds from the sale of certain of the checks to his own use. Plaintiff sued to recover the amount of these checks and the court affirmed a judgment of the trial court in favor of the defendant, stating that:

> "It is fundamental that if a duty of the master be violated by his employee the master is liable the same as though he personally were guilty of the breach. Such liability of the master is not obviated by the fact that his servant acted contrary to instructions and criminally. *Muehlebach* v. *Paso Robles Hotel Co.,* 65 Cal. App. 634, 225 P. 19. The fact that the faithlessness of the employee in commiting the wrong may amount to a felony does not alter the obligation of the agent to his principal so long as the servant is acting within the scope of his employment. *Ibid; Hiroshima* v. *Pacific Gas & Electric Co.,* 18 Cal. App. 2d 24, 63 P. 2d 340; *Grigsby* v. *Hagler,* 25 Cal. App. 2d 714, 78 P. 2d 444. Because May exceeded his authority in withholding proceeds received by him from the sales of the cheques does not relieve plaintiff; in issuing the cheques he was acting within the scope of his employment. * * *"

Smead was also the direct employee of American Fidelity and American Plan. His actions, while serving in the dual capacity of Lotz' General Manager and of American Fidelity's and American Plan's representative, are binding on all for whom he acted. That the device, for example, of the American Fidelity Rewrite was suggested to American Plan and American Fidelity by Smead rather than Hart or any other of the defendants' representatives, is completely immaterial and all the defendants are liable for Smead's acts. Hart himself admitted that Smead was the agent of American Fidelity (R. 909). The court's em-

phasis on Lotz' reliance on Smead clearly demonstrates its misconception of the proper rule of law applicable to this situation.

Mid-States' Knowledge of the Acts of the Defendants Subsequent to August 13, 1951.

Hatfield left for Oakland on November 23, 1951 (R. 208), following a telephone conversation from Oldberg, Mid-States' resident Vice-President in Los Angeles, on November 20, 1951 (R. 209). Mr. Csar, Mid-States' staff counsel, accompanied Hatfield. They arrived in Oakland on November 24, 1951 (R. 225). By that time American Fidelity's account had been paid in full (R. 643). At that time Hatfield saw Lotz, Smead and Lotz' attorney, Mead (R. 209). A meeting was held in the Leamington Hotel, at which Hatfield, Csar, Oldberg, Kledzik and Lotz were present. Smead was not present. At that meeting Lotz stated that he thought he was about $100,000 short (R. 226). The next morning a further meeting was held at the Leamington Hotel in Oakland, at which time Lotz, Smead and Mead were all present and a discussion was held as to how Mid-States could keep Lotz operating with a view to his coming out of his financial difficulty (R. 226-227). Lotz stated that his financial condition was due to his operating costs and the payment of too high a rate of commission to brokers. Nothing was said about the cancellation of Lotz' contract with American Fidelity or the Public Service Rewrite (R. 228).

On November 27 a further conference was held with Lotz, Smead and Mead at the Leamington Hotel and also in Mead's office, at which time plaintiff's Exhibit 6 was typed, signed by Lotz and witnessed by Mead (R. 229-233, 1010-1011). Hatfield reviewed the entire past with Smead in Lotz' presence and Lotz "concurred in most of

it'', following which Hatfield called his principals in Chicago (R. 646). Csar left Oakland on November 30 and took plaintiff's Exhibit 6 back with him to Titus in Chicago (R. 234). The latter came out to Oakland on December 5, following which he had conferences with Lotz and Smead (R. 234). Following these conferences the statements of Smead and Lotz previously referred to (Plaintiff's Exhibits 11, 12, 13, 22 and 31) were signed and delivered.

On December 4, 1951 Hatfield and Lotz went to the insurance department in San Francisco (R. 236) and Lotz then told Hatfield about the New York meeting with Hart and the representatives of American Fidelity (R. 236-237) and he stated to Hatfield substantially the facts set forth in the statement Smead signed under date of December 6, 1951 (Plaintiff's Exhibit 11). Lotz at no time denied this conversation.

Thus, knowledge of the various breaches of Lotz' fiduciary duties and the participation of the defendants therein did not actually come to Mid-States until December 4, 1951, when Lotz made disclosure of the facts to Hatfield. Although some facts became known to Mid-States on November 20, 1951, by that time likewise all of the wrongful acts of the defendants had been effected, American Fidelity had been paid in full, and Lotz was indebted to Mid-States for more than $400,000. Until this disclosure Lotz' account with Mid-States had been substantially current; no business had been written for Mid-States in April, May or July and only $32,000 in June, and payment of the June balance had been made on October 15, 1951. Mid-States accordingly had no knowledge of Lotz' insolvency. No disclosure had been made of the loan by American Plan to Lotz in August, 1951 for the purpose of making his account with American Fidelity appear to be current, although the transaction was simply a transfer of the ac-

count payable from one company to another. No disclosure had been made by anyone that the Public Service Rewrite checks had been made payable to Mid-States and deposited in Lotz' account, and that substantially all the proceeds therefrom had been remitted to American Fidelity, and there was no occasion for any inquiry with respect thereto by Mid-States, since payment of the premiums on the Rewrite would not be due under Lotz' contract with Mid-States for 60 days following the end of September. Obviously, in view of these facts, coupled with Hart's misrepresentations to Hatfield in the telephone conversation of October 31, 1951, Mid-States had no reason to make any inquiry of Lotz regarding his financial affairs.

The court concluded that this case is governed by the rule that a debtor may prefer one creditor over another in the absence of fraud or breach of fiduciary obligation, and held that (a) the acts of the defendants were not fraudulent, and (b) that no fiduciary relationship existed between Lotz and Mid-States and, therefore, no breach of such obligation occurred. It is submitted that in the instant case the acts of the defendants go far beyond the creation of a mere preference. The conduct of American Fidelity and American Plan, in concert with the remaining defendants, even goes far beyond the conduct of the recipient creditor and the other parties in the case of *Machado* v. *Katcher Meat Co.,* 108 Cal. App. 2d 1, 237 P. 2d 715 (1951) in which all of the defendants were held liable for the indebtedness owing by the debtor corporation to the plaintiff creditor. The trial court attempted to distinguish the *Machado* case on the ground that in that case the recipient creditor knew that the plaintiff and other creditors could not be paid while in the instant case the defendants had no such knowledge. The trial court further stated in its opinion that in this case no motive was shown for Lotz to engage in a fraudulent plan, while in the *Machado* case

a motive consisting of the intimacy of the recipient creditor with the principal officers of the debtor corporation was sufficient motive. The trial court further concluded that Lotz' motive to continue in business was not a sufficient basis upon which to predicate a finding of wrongful conduct on his part. It is submitted that this attempted distinction between the cases is without basis, since the acts of Lotz were clearly in breach of his fiduciary duties to Mid-States, and the acts of all the defendants acting in concert with him created the indebtedness of Lotz to Mid-States for the express purpose and with the actual result of providing the very source out of which to make American Fidelity whole at the expense of Mid-States while Lotz was insolvent.

II.

ALL WHO PARTICIPATE IN THE BREACH BY AN AGENT OF HIS FIDUCIARY OBLIGATIONS TO HIS PRINCIPAL OR WHO RECEIVE THE BENEFITS OF SUCH BREACH WITH KNOWLEDGE THAT THE AGENT'S ACTIONS ARE A BREACH OF HIS FIDUCIARY DUTIES, ARE EQUALLY LIABLE WITH HIM TO THE PRINCIPAL REGARDLESS OF THE EXTENT OF THEIR PARTICIPATION.

In *Duckett* v. *National Mechanics' Bank of Baltimore,* 86 Md. 400, 38 A. 983, 39 L. R. A. 84 (1897), the court said:

> "There can be no dispute that as a general principle all persons who knowingly participate or aid in committing a breach of trust are responsible for the wrong, and may be compelled to replace the fund which they have been instrumental in diverting. Every violation by a trustee of a duty which equity lays upon him, whether wilful or fraudulent, or done through negligence, or arising through mere oversight or forgetfulness, is a breach of trust; 2 Pom. Eq. Jur. § 1079. There is in such instances no primary or secondary liability as respects the parties guilty of, or participating in, the breach of trust; because all are

> equally amenable. * * * Whoever knowingly aided him, or knowingly participated with him in misapplying that fund, is by reason of so aiding and so participating, equally liable with him to make the fund good by restoring it to the trust estate; 2 Pom. Eq. Jur. § 1079. * * *"

In *Herron* v. *Hughes,* 25 Cal. 555 (1864), the court held that where the property of the principal was transferred by the agent without the principal's knowledge to another in satisfaction of a debt with the payee's knowledge of the agency, the payee was liable to the principal.

A further illustration of the erroneous conclusion of the trial court that the defendants are without liability to Mid-States is apparent from its findings and conclusions regarding the defendants' fraudulent intent. Constructive fraud results when one takes adavantage of his fiduciary relationship to obtain an advantage at the expense of the confiding party and no fraudulent intent need be proved. The court stated in its opinion that no motive was shown for Lotz to engage in a fraudulent plan (R. 106); that Lotz had the intention of remaining in business but that he did not reap any benefits as the result of the alleged fraudulent conspiracy (R. 108); and that Lotz did not intend to conduct himself fraudulently in trying to save his business (R. 110). These conclusions are set forth in Finding XIV, R. 130-135. Apparently the court's conclusions are based on the theory that no breach of a fiduciary obligation is actionable unless it is proved that the breach was the result of a fraudulent intent. It is submitted that this view is clearly contrary to the uniform holding of the authorities. Thus, Section 1572 of the California Civil Code provides:

> "*Actual fraud, what.* Actual fraud, within the meaning of this chapter, consists in any of the following acts committed by a party to the contract, or with

his connivance with intent to deceive another party thereto *or* to induce him to enter into the contract.

"1. The suggestion, as a fact of that which is not true by one who does not believe it to be true.

"2. The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true though he believes it to be true.

"3. The suppression of that which is true by one having knowledge or belief of the fact.

"4. A promise made without any intention of performing it; or

"5. Any other act fitted to deceive."

Section 1573 of the California Civil Code defines constructive fraud as consisting

"* * * 2. In any such act or omission as the law specially declares to be fraudulent, without respect to actual fraud, * * *"

This section was applied by the court in *In Re Arbuckle's Estate,* 98 Cal. App. 2d 562; 220 P. 2d 950 (1950) where the court said:

"Fraud is either actual or constructive. It is conceded that actual fraud is not present here. Civil Code section 1573 defines constructive fraud as consisting: '* * * 2. In any such act or omission as the law specially declares to be fraudulent, without respect to actual fraud.' Fraud assumes so many shapes that courts and authors have ever been cautious in attempting to define it. Each case must be considered on its own facts. 12 Cal. Jur. 705, sec. 2. In its generic sense, constructive fraud comprises all acts, omissions and concealments involving a breach of legal or equitable duty, trust, or confidence, and resulting in damage to another. In *re Hearn's Will,* 158 Misc. 370, 285 NYS 935, 941; *In re Dorrity's Will,* 118 Misc. 725, 728, 194 NYS 573, 575; 37 CJS, Fraud §§ 1, 2 and 3 pages 204, 211, 213. Constructive fraud exists in cases in which conduct, although not actually fraudulent,

ought to be so treated,—that is, in which such conduct is a constructive or quasi fraud, having all the actual consequences and all the legal effects of actual fraud. *Herd* v. *Tuohy,* 133 Cal. 55, 62, 65 P. 139; *Higgins* v. *California Petroleum etc. Co.,* 147 Cal. 363, 368, 81 P. 1070; *Higgins* v. *California Petroleum etc. Co.,* 122 Cal. 373, 376, 55 P. 155; *Younglove* v. *Hacker,* 15 Cal. App. 2d 211, 217, 59 P. 2d 451; 12 Cal. Jur. 710, sec. 5; cf. *In re Dorrity's Will,* 118 Misc. 725, 194 NYS 573; *Schultz* v. *Schultz,* 35 NY 653, 91 Am. Dec. 88; *Rose* v. *Hunnicutt,* 166 Ark. 134, 265 S. W. 651."

Defendants' Liability for the Damages Arising Through Their Concerted Action.

The trial court found that no conspiracy to defraud Mid-States existed among the defendants. This finding is apparently predicated on two bases: (1) that the action of Lotz and the other defendants, in misrepresenting the facts to Mid-States both by affirmative misrepresentations and non-disclosure of other facts and in diverting Mid-States' funds to American Fidelity, did not constitute fraud because of a presumed lack of intent to defraud, and (2) because no specific prior agreement to perform all these acts was entered into.

It is submitted that the first basis is clearly erroneous and is founded upon incorrect inferences and legal conclusions and a failure to recognize the applicable legal principles. One such error, not previously mentioned, is the court's reference to the fact that Lotz did not reap any benefits from the transactions, that "it is an incompetent conspirator, indeed, who at the completion of his 'fraud' ends up in a worse financial condition than when he started," and that his sole object was to stay in business (R. 108). The specific intent to defraud is thus confused by the court with the motivation for Lotz' acts. The intent to defraud is the intention to accomplish an act which results in de-

frauding another; the motivation is, except in most unusual circumstances, never the defrauding as such, but the accomplishment of some other end, such as self-advantage.

In this case, Lotz was admittedly not motivated by a desire to obtain and keep Mid-States' money, but to relieve himself from the unceasing pressure of a demanding creditor which, if not satisfied, would force him out of business. The sole method whereby this could be accomplished was to shift the unpayable debt to Mid-States' shoulders, Lotz believing that because Mid-States was not pressing him at the moment (since he was current in his account with it) that he could get sufficient time by such device to obtain a loan or effect some other method whereby he could continue in business. In other words, he was admittedly grabbing at straws—he bought time with Mid-States' money. That his motivation was to obtain time rather than money for himself does not, of course, make his acts in breach of his fiduciary duties any less actionable; as pointed out above, the intent to defraud follows as a matter of law from his acts.

That Lotz did not actually enrich himself but ended up owing even more money than he had previously owed does not mean that he was not a conspirator. The purpose of his acts was to obtain time by creating a large indebtedness to Mid-States' and using its money to pay off American Fidelity and American Plan, which would give him no time. He created the debt and obtained the time. He knew, for example, that the Public Service Rewrite would result in an immediate loss to himself since he had to pay a 25% commission and received an advance commission of only 15%, but, although he had an immediate 10% loss, he did obtain some 60 days of time. Of course, even if he had not obtained that which he hoped to gain from the conspiracy, that fact alone would not prove or tend to prove

the absence of the conspiracy. That a thief steals an empty purse makes him no less a thief, and the cat's-paw who performs the crime and then is cheated of his ill-gotten gains by his colleagues is not rendered innocent by the fact that he failed to profit thereby. These principles seem so clear that no citation of authorities is deemed necessary, yet the trial court apparently gives great weight to the fact that Lotz did not enrich himself monetarily.

The fact that the court believed that the defendants never sat down together and entered into a specific prior agreement outlining the steps they would take and the objective thereof does not mean that no conspiracy existed. As the court said in *Ball* v. *Paramount Pictures, Inc.,* 169 F. 2d 317 (C.C.A. 3, 1948) at page 319, concerning the finding of the District Court that the defendants did not conspire together,

> "* * * In so holding we think the lower court failed to accept the clear implications arising from appellees' acts and conduct. 'The picture of conspiracy as a meeting by twilight of a trio of sinister persons with pointed hats close together belongs to a darker age.' *William Goldman Theatres* v. *Loew's Inc.,* 3 Cir., 150 F. 2d 738, 743. As held in that case, conspiracy may be inferred when the concert of action 'could not possibly be sheer coincidence.' "

In this case, it is clear that the efforts of all the defendants were devoted solely to paying off Lotz' indebtedness to American Fidelity as quickly as possible with funds obtained through the creation of debts to Mid-States while Lotz was insolvent. The obtaining of insurance business for Mid-States was of no importance whatsoever except as the obtaining of such insurance might generate funds with which Lotz' indebtedness to American Fidelity could be paid. Insurance was written without regard to proper rate structure or possible profit to

either Mid-States or Lotz, and without regard to any other matter except as to how quickly how much money could be forthcoming, which, in turn, could be diverted to American Fidelity. This end was admittedly the sole reason for Smead's employment by American Fidelity and American Plan and all the defendants participated in effecting that result.

The acts of the defendants were so successful that Lotz' indebtedness to American Fidelity of some $240,000 was reduced to $61,000 and his indebtedness to Mid-States increased from $30,000 to approximately $400,000 within a period of less than three months! When it became apparent that further funds would not be forthcoming quickly enough, the balance owing by Lotz to American Fidelity was finally liquidated by saddling Mid-States with the American Fidelity Rewrite, even though it was obvious to all that this transaction would result in direct pecuniary loss to Lotz and an indebtedness to Mid-States which he was unable to pay. Lotz was guaranteed a 20% commission by American Fidelity. No such guarantee would be realized by Lotz once the policies were rewritten by Mid-States. Not only was Lotz told that he would not obtain his 15% advance commission from Mid-States on this transaction, but as American Fidelity and American Plan knew, the loss ratio was such that Lotz would in all likelihood get no commission whatsoever from the transaction although he would have received 20% from American Fidelity if the Rewrite had not been made.

As has been demonstrated above, the action of Lotz in diverting to American Fidelity premiums arising from Mid-States' business, including the endorsement of checks received for the Public Service Rewrite and payment of substantially all the proceeds thereof to American Fidelity were clear breaches of his fiduciary duty to Mid-States. Even if the premiums were not trust funds in his hands,

there was no question but that Lotz' losses were accumulating even faster as a result of these rewrites and that Mid-States could not hope for payment. These facts were equally well known to American Plan and American Fidelity and their concerted action, in the words of the court in *Ball* v. *Paramount Pictures, Inc.* "could not possibly be sheer coincidence." The concerted action constituted a participation by American Fidelity and American Plan and their employee, Smead, in Lotz' breach of trust. That all who participate with an agent or other fiduciary in his breach of trust or who receive the benefits thereof with knowledge that his actions are in breach of his said duties, are equally liable with him, is well established. This is true regardless of the extent of the participation and regardless of whether or not the participant received the benefits thereof. As stated in 3 Scott on Trusts, Section 326.5, where the case of *Anderson* v. *Daley,* 38 App. Div. 505, 56 N. Y. Supp. 511 (1899) was being discussed:

> "* * * It was held that the secretary was liable to the beneficiaries for participation in the breach of trust. It was immaterial that the defendant did not intend to cheat the beneficiaries and honestly intended that the fund should be restored at some future time. The court said that he was an active participant in the use of the trust money, and that he could not shield himself by the fact that he was an officer of the corporation and that the misuse of the trust fund was not for his own benefit but for the benefit of the corporation."

In the same section the case of *Proctor* v. *Norris,* 285 Mass. 161, 188 N. E. 625 (1934) was discussed where "the court held that it was immaterial that the defendant did not personally benefit by the transaction * * *."

The law of California is in complete accord with this well established principle. In *Anderson* v. *Thacher,* 76 Cal. App. 2d 50, 172 P. 2d 533 (1946), the fiduciary was a

real estate broker who made a secret profit on a transaction in which he, as agent, represented the plaintiff. Another defendant was a Margaret Johnstone, an ill woman over 75 years of age, whose name was used, with her knowledge, as the purported purchaser of the property. The court found that the defendant Johnstone did not receive any of the profits from the transaction. She was held equally liable with the agent Thacher for all the damages sustained by the plaintiff. The court pointed out that her conduct in allowing her name to be used as a "dummy" in the transaction was "illegal and in furtherance of the common scheme or design to achieve the unlawful purpose of the conspiracy. As heretofore pointed out, the liability of a conspirator is not dependent on whether such conspirator receives any of the benefits of the conspiracy." (P. 74.) In discussing the liability of still a third participant, Sackett, the court said, at page 72:

> "This defendant occupied no fiduciary relation to plaintiff and his liability is dependent on whether he joined a conspiracy to defraud plaintiff through the making of a secret profit to be divided between plaintiff's fiduciary Thacher and defendant Sackett. If through fraud and conspiracy other defendants assisted defendant Thacher in violating his obligation to his principal by making a secret profit and by retaining the proceeds therefrom, they, as well as the fiduciary Thacher, are equally liable for all the consequences of the conspiracy, regardless of the extent of their participation or the share of the secret profits obtained by them. *It is not the conspiracy but the civil wrong which gives rise to the cause of action. If plaintiff is successful in proving an injury of the nature claimed she may recover in her action against all those who have united or cooperated in inflicting that injury.* (*Revert* v. *Hesse,* 184 Cal. 295 (193 P. 943).) And where, after the violation of a fiduciary obligation, an amount is found to be due from the

agent, judgment for the same amount may also be rendered against those proven to have fraudulently aided in the attempt of the fiduciary to obtain secret profits, although they themselves are not fiduciaries, and even though they receive no share of the profits (*Lomita Land & Water Co.* v. *Robinson,* 154 Cal. 36 (97 P. 10, 18 L. R. A. N. S. 1106)). * * *'' (Italics supplied.)

In that case, as here, no specific ''round table'' conspiracy or agreement was found by the court, the conspiracy consisting of the concerted action and the cooperation of the defendants, the California court recognizing, as did the Federal court in *Ball* v. *Paramount Pictures, Inc.,* that the ''meeting by twilight of a trio of sinister persons with pointed hats close together'' is not a prerequisite of a conspiracy.

In this case all the defendants except Hart, did in fact benefit directly by Lotz' breach of his fiduciary duty and their participation was for their own direct benefit. As previously stated, Lotz secured what he desired—time within which he could continue in business and stave off bankruptcy. American Fidelity and American Plan received payment of some $240,000 of indebtedness, most of which would otherwise have been uncollectible. By the continuation of Lotz' business Smead was assured of continued employment. Hart is in the same position as the corporate officer in the case of *Anderson* v. *Daley* referred to by Scott and he cannot ''shield himself by the fact that he was acting as an officer of the corporation and that the misuse of the trust fund was not for his own benefit but for the benefit of the corporation.''

In *Duckett* v. *National Mechanics' Bank of Baltimore,* 86 Md. 400, 38 A. 983, 39 L. R. A. 84 (1897), the court said:

''There can be no dispute that as a general prin-

> ciple all persons who knowingly participate or aid in committing a breach of trust are responsible for the wrong, and may be compelled to replace the fund which they have been instrumental in diverting. Every violation by a trustee of a duty which equity lays upon him, whether wilful or fraudulent, or done through negligence, or arising through mere oversight or forgetfulness, is a breach of trust; 2 Pom. Eq. Jur. § 1079. There is in such instances no primary or secondary liability as respects the parties guilty of, or participating in, the breach of trust; because all are equally amenable. * * * Whoever knowingly aided him, or knowingly participated with him in misapplying that fund, is by reason of so aiding and so participating, equally liable with him to make the fund good by restoring it to the trust estate; 2 Pom. Eq. Jur. § 1079. * * *''

This principle is so well established that there is no need to belabor the point by citing additional authorities. As the Supreme Court of the United States said in *Smith* v. *Ayer,* 101 U. S. 320 (1880) at page 327:

> ''The adjudications in support of this doctrine are very numerous. The doctrine pervades the whole law of trusts.''

Plaintiff in its complaint charged that American Fidelity, American Plan and Hart conceived and prepared the plan whereby Mid-States' funds were to be diverted to American Fidelity and that this plan was communicated to and agreed upon with defendants Lotz and Smead at the meeting of August 13, 1951, all as shown by the statements of Lotz and Smead. Plaintiff believes that it has proved the specific allegations of the complaint and that the findings of the court to the contrary are clearly erroneous. However, as pointed out above, even if there were no such specific prior agreement, the concerted action of the defendants in which all participated in Lotz' breach of his fiduciary duties constitutes proof of

a conspiracy to defraud and on this proof Mid-States is entitled to recover against the defendants since it is well established that under the Federal Rules of Civil Procedure every party should receive the relief to which it is entitled upon any theory applicable to or sustained by the facts as established at the trial.

Thus, in *Hamill* v. *Maryland Cas. Co.,* 209 F. 2d 338 (C. A. 10, 1954), suit was instituted and prosecuted on the theory that the two defendants were partners and, therefore, jointly liable to indemnify the plaintiff who had incurred liability as surety on a bond on which defendant Gunnell was principal. The court rejected the partnership theory in its entirety, but gave judgment for the plaintiff in a reduced amount against Hamill on the Gunnell bond on the basis that the plaintiff had become surety on the bond in reliance upon a contract made between the two defendants which was made for plaintiff's benefit. On appeal by Hamill from the judgment, the Court of Appeals pointed out that

> "Of course Maryland may recover upon any theory legally sustainable under established facts regardless of the demand in the pleadings. See Rule 54(c) F. R. C. P., Rule 15(b) F. R. C. P., 28 U. S. C. A.; *Garland* v. *Garland,* 10 Cir., 165 F. 2d 131; *Preas* v. *Phebus,* 10 Cir., 195 F. 2d 61; *Blazer* v. *Black,* 10 Cir., 196 F. 2d 139, 147; *Schoonover* v. *Schoonover,* 10 Cir., 172 F. 2d 526. * * *" (page 340).

To the same effect is *Garland* v. *Garland,* 165 F. 2d 131 (C. C. A. 10, 1947), where a suit was brought for rescission and cancellation of a contract, but the court gave judgment for the plaintiff consisting of specific performance and damages for breach. On appeal by defendants, the judgment was affirmed, the court ruling that

> "* * * Under the wide sweep of Rule 54(c), *supra,* it was within the jurisdiction and power of the

court to grant plaintiff equitable relief by way of specific performance of the contract relating to the possession and use of the residential premises on the Orchard Ranch as well as the furniture and furnishings reasonably necessary to that end, even though she sought rescission and cancellation. Cf. *Truth Seeker Co.* v. *Durning,* 2 Cir., 147 F. 2d 54; *Ring* v. *Spina,* 2 Cir., 148 F. 2d 647, 160 A. L. R. 371. * * *'' (page 133).

The case of *Blazer* v. *Black,* 196 F. 2d 139 (C. A. 10, 1952), is particularly apropos in this respect. In that case, the plaintiff, a former stockholder of a corporation, sought damages against the defendant, a former director and officer of the corporation, resulting from the defendant's fraudulent scheme whereby defendant acquired plaintiff's stock at less than its real value by virtue of concealing, in violation of his fiduciary duty to disclose the same, certain material facts relating to the true financial condition of the corporation, which concealment was part of the fraudulent scheme. Allegations of fact with respect to what transpired following the sale of plaintiff's stock were stricken by the trial court and an amended complaint not setting forth these transactions was filed, which, however, contained allegations of the fraudulent scheme, the fiduciary relationship, the fraudulent representations and the concealment of material facts. The trial court directed a verdict for the defendant and entered a judgment thereon. On appeal the judgment was reversed, the Court of Appeals pointing out that

''* * * The court was not warranted in dismissing the action unless upon the facts and law he had shown no right to relief in law or equity. Rule 54(c). *Preas* v. *Phebus,* 10 Cir., 195 F. 2d 61; *Schoonover* v. *Schoonover,* 10 Cir., 172 F. 2d 526; *Garland* v. *Garland,* 10 Cir., 165 F. 2d 131; *Hawkins* v. *Frick-Reid Supply Corp.,* 5 Cir., 154 F. 2d 88; *Kansas City, St. L. & C. R. Co.* v. *Alton R. Company,* 7 Cir., 124 F. 2d 780.